

GOVERNOR'S

Budget Highlights: 2005-06



**Arnold Schwarzenegger, Governor
State of California**

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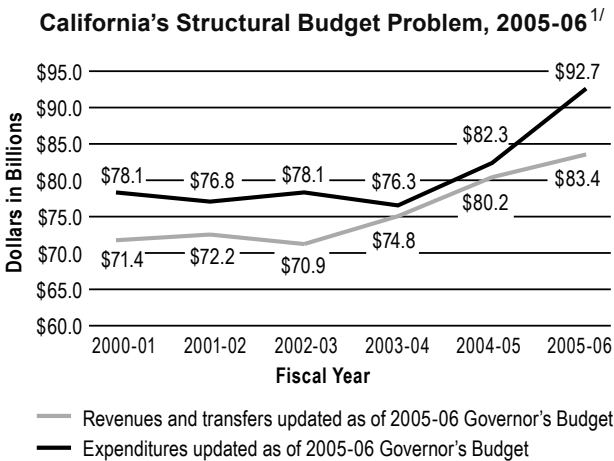
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Introduction

Figure INT-01

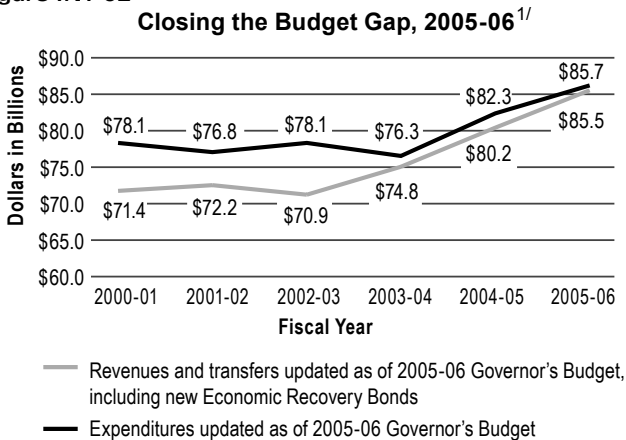


1/ The 2003-04 and 2004-05 amounts have been adjusted to reflect the actual use of the Economic Recovery Bonds in 2004-05.

In the absence of corrective actions to slow spending growth, and the policy changes proposed, the State would spend \$92.6 billion General Fund in 2005-06 (Figure INT-01 shows \$92.7 billion because of policy changes). At the same time, the baseline estimate of resources available in 2005-06 is \$84.2 billion. In addition, the Budget rec-

ognizes the need to provide for a reserve of \$500 million and to fund other adjustments totaling \$170 million General Fund. Thus in the absence of any policy changes to close the budget gap, the gap would have been \$9.1 billion. This gap is due to: (a) an operating deficit in 2004-05 of \$1.7 billion, (b) a gap between the growth in baseline expenditures and revenues of \$5.2 billion, (c) the loss of \$2 billion of Economic Recovery Bonds that were used to help fill the gap in 2004-05, and (d) \$170 million for other adjustments.

Figure INT-02



1/ The 2003-04 and 2004-05 amounts have been adjusted to reflect the actual use of the Economic Recovery Bonds in 2004-05.

The policy changes to close the gap consist mostly of reductions in the rate of increase of spending, totaling \$7 billion. The major reductions proposed to help close the budget gap in 2005-06 are discussed in the Overview of General Fund Revenues and Expenditures.

The Budget proposes to close the gap by also increasing available resources by (a) using \$1.7 billion of the Economic Recovery Bonds, which is about \$300 million less borrowing than was included in the Budget Act of 2004 and

Figure INT-03

Closing the Gap

(Dollars in Millions)

	2005-06
Workload Budget Resources	\$84,198
Workload Budget Expenditures	92,620
Funding Gap at Workload Budget	-\$8,422
Adjustments Due to Policy Decisions	-170
Funding Gap with Policy Decisions	-\$8,592
Total Policy Decisions to Close the Budget Gap:	
Proposition 98	\$2,284
Non-Proposition 98:	
Business, Transportation and Housing	1,311
Health and Human Services	1,167
General Government	928
Education	543
Resources	475
Youth and Adult Correctional	272
Others	20
New Economic Recovery Bonds	1,683
Revenue Issues	409
Total	\$9,092
General Fund Reserve	\$500

(b) a variety of proposals to increase revenues by a total of \$409 million without tax increases. These solutions provide for a General Fund reserve of \$500 million.

Overview of General Fund Revenues and Expenditures

While revenues are projected to increase again in 2005-06, expenditures, without changes, would outpace those additional revenues. When comparing revised figures for 2004-05 to the proposed 2005-06 Budget, nearly all areas have not increased as much as current funding formulas would prescribe, including Health and Human Services, K-12 Education, and State employees compensation.

Figure INT-04 compares General Fund revenues and expenditures in 2005-06 to the current year. As the table

Figure INT-04

**General Fund Revenues and Expenditures
2004-05 Revised vs. 2005-06 Proposed**

(Dollars in Millions)

REVENUES	Revised 2004-05	2005-06	Dollar Change	Percent Change
Revenues	\$77,903.9	\$83,227.5	\$5,323.6	6.8
Transfers	315.2	544.0	228.8	72.6
Totals, Revenues and Transfers	78,219.1	83,771.5	5,552.4	7.1
New Economic Recovery Bonds	2,012.0 ^{1/}	1,682.8	-329.2	-16.4
Total	\$80,231.1	\$85,454.3	\$5,223.2	6.5
EXPENDITURES				
NON-PROPOSITION 98:				
Governor's Office	\$18.4	\$18.3	-\$0.1	-0.5
Remaining Executive	793.2	759.8	-33.4	-4.2
Legislature	297.7	309.9	12.2	4.1
Judicial	1,763.7	1,928.2	164.5	9.3
State and Consumer Services	534.9	563.4	28.5	5.3
Business, Transportation and Housing	376.6	380.3	3.7	1.0
Resources/Environmental Protection	1,140.8	1,338.7	197.9	17.3
Health and Human Services	25,518.6	26,689.2	1,170.6	4.6
Youth and Adult Correctional	6,896.9	6,979.7	82.8	1.2
Non-Proposition 98 Education	7,911.8	8,589.3	677.5	8.6
STRS Contribution	1,148.8	581.4	-567.4	-49.4
Labor and Workforce Development	87.2	87.2	0.0	0.0
General Government	1,682.5	980.1	-702.4	-41.7
Total - Non-Proposition 98	\$48,171.1	\$49,205.5	\$1,034.4	2.1
PROPOSITION 98:	\$34,123.8	\$36,532.3	\$2,408.5	7.1
TOTAL — ALL EXPENDITURES	\$82,294.9	\$85,737.8	\$3,442.9	4.2

^{1/} For the purposes of this table, this amount is included in General Fund resources to provide better comparability. It was budgeted as a reduction in expenditures in the 2004 Budget Act.

shows, the Budget anticipates that revenues will increase by 6.8 percent. Because the Budget proposes to make less use of new Economic Recovery Bonds than in the 2004-05 year, total General Fund resources available are expected to increase by a slightly lower percentage.

This figure also shows that General Fund expenditures are proposed to increase by 4.2 percent over the current year. The specific expenditure changes are summarized below.

Governor's Office

Expenditures are proposed to decrease \$24,000, or 0.1 percent. This decrease is primarily due to a reduction of \$282,000, offset by increases of \$199,000 for dues in interstate organizations and \$50,000 for price increases.

Remaining Executive

Expenditures are proposed to decrease \$33.4 million, or 4.2 percent. The decrease is primarily due to the removal of one-time funding in 2004-05 for Southern California wildfires in the Office of Emergency Services budget. New expenditures for firefighting equipment update and maintenance, however, are included in Resources and Environmental Protection.

Legislature

Expenditures are expected to increase by \$12.2 million, or 4.1 percent, primarily due to an adjustment based on the growth in the State Appropriations Limit.

Judicial

Expenditures are proposed to increase \$164.5 million, or 9.3 percent. This increase is primarily attributable to the following:

- Application of a statutorily required growth factor to the budget of the State Trial Courts, at a cost of \$97.4 million.
- Restoration of one-time reductions totaling \$60.5 million.

- Augmentation of the State Trial Courts for increased employee compensation and benefits expenditures by \$4.1 million.

State and Consumer Services

Expenditures are proposed to increase by \$28.5 million, or 5.3 percent. The major adjustments contributing to this increase are as follows:

- \$10.4 million and 116.3 positions for the Franchise Tax Board (FTB) to assist in closing the tax gap and ensuring that all Californians pay their fair share of the tax burden. These proposals should increase revenues by \$76.8 million in 2005-06.
- Child Support Automation project costs at the FTB increase \$26.3 million.
- Costs of the 2004 Tax Amnesty program are reduced by \$9 million.
- Agency General Fund support budgets are reduced by \$8.3 million, which the Agency Secretary will have the discretion to achieve through hiring restrictions, layoffs, procurement reductions, or other administrative measures.
- A net increase of \$2.2 million for the Department of General Services attributable to proposed seismic retrofit costs (\$16.9 million) at San Quentin State Prison. This expenditure is offset by reductions of \$14.7 million resulting from the removal of one-time expenditures for 2004-05.

Business, Transportation and Housing

Expenditures are proposed to increase by \$3.7 million, or 1 percent. This increase consists of workload increases

totaling \$4.6 million, or 1.2 percent, offset by the following major policy changes proposed to close the budget gap:

- Proposition 42 transfer from the General Fund will be suspended in 2005-06, for a savings of \$1.3 billion. Since this transfer was also suspended in 2004-05, there is no change in funding between 2004-05 and 2005-06.
- Emergency Housing Assistance Program grants for shelter and services to homeless persons are reduced \$0.9 million to \$3.1 million.

Resources and Environmental Protection

Expenditures are proposed to increase by \$197.9 million, or 17.3 percent. This increase results from several expenditure changes, the most significant of which are as follows:

- Legislation enacted in 1998 appropriated \$235 million to line the All American Canal and fund other projects to reduce California's dependence on water from the Colorado River. \$59 million of that will be expended in 2005-06 to line the canal.
- Employee compensation costs for the Department of Forestry and Fire Protection will increase by \$47 million. In addition, a \$23 million augmentation is proposed to fund various firefighting improvements recommended by the Blue Ribbon Fire Commission, and a \$25 million augmentation is proposed for the emergency firefighting fund.
- Debt service for Resources land acquisitions and capital improvement projects approved in prior years has increased by \$44 million.

Health and Human Services

Expenditures are proposed to increase by \$1.2 billion from the revised 2004-05 Budget, or 4.6 percent. This increase consists of caseload and other workload increases totaling \$2.3 billion, or 8.9 percent, offset by the following major policy changes proposed to close the budget gap:

- California Work Opportunity and Responsibility to Kids (CalWORKs) Program savings totaling \$449 million by reducing grants by 6.5 percent for a savings of \$212 million; by suspending the CalWORKs July 1, 2005 Cost of Living Adjustment (COLA) for a savings of \$164 million; and by reducing the earned income disregard for a savings of \$73 million.
- Medi-Cal savings totaling \$260 million consisting of \$191 million savings from maximizing federal funds through a fund shift from the State-only General Fund program to federal funds for prenatal care; \$57 million savings from redirecting Proposition 99 funds to capture General Fund savings and maximize federal funds in the Access for Infants and Mothers (AIM) program, and \$12 million savings from Medi-Cal Redesign.
- Supplemental Security Income/State Supplementary Payment (SSI/SSP) savings totaling \$259 million General Fund by suspending the January 1, 2006 State COLA for a savings of \$174 million, and by capturing General Fund savings of \$85 million, equivalent to the amount of the January 1, 2006 federal SSI COLA.
- In-Home Supportive Services (IHSS) savings totaling \$195 million from rolling-back the State's portion of provider wages and health benefits to minimum wage (\$6.75 per hour); the State currently contributes up to \$10.10 per hour. Counties have the option of reinvesting in local savings (\$112 million from 2004-05 and \$93 million from 2005-06) obtained by the

Administration under the IHSS waiver. This reduction will avoid more severe reductions in services.

Youth and Adult Corrections

Expenditures are proposed to increase by \$83 million, an increase of 1.2 percent over fiscal year 2004-05. This increase consists of population and other workload increases totaling \$287 million, or 4.1 percent, adjusted by the following major policy changes proposed to close the budget gap:

- A reduction of \$134.3 million General Fund due to funding local probation activities from Temporary Assistance for Needy Families (TANF) resources. The Department of Social Services' budget will provide \$201.4 million in TANF funding for juvenile probation, which is the same level of funding provided in prior years.
- A \$95.3 million reduction in the Department of Corrections inmate and parolee programs.
- An increase of \$25 million associated with funding for the Juvenile Justice Crime Prevention program to be distributed to counties by the Board of Corrections. This increase is part of a net \$75 million reduction, as \$100 million of savings is reflected in the Local Government Financing budget for this program.

Non-Proposition 98 Education

Expenditures are proposed to increase by \$677.5 million, or 8.6 percent. This increase consists of various baseline adjustments including the backfill of a one-time current year cost shift from General Fund to the Student Loan Operating Fund, enrollment growth and cost increases in higher education pursuant to the Governor's Compact with the University of California and California State University, caseload growth in financial aid, and other workload

increases including General Obligation Bond debt service totaling \$752 million, or 9.5 percent, offset by the following major policy changes proposed to close the budget gap, totaling \$75.2 million:

- A one-time cost shift from the General Fund to the Student Loan Operating Fund in the Student Aid Commission of \$35 million for the budget year.
- Elimination of some of the one-time cost increases resulting from augmentations by the Legislature over the May Revision agreed-upon 2004-05 funding level related to the Higher Education Compact totaling \$28.1 million.
- Local assistance reductions to the Student Aid Commission allocated to a reduction in the maximum CalGrant award for students attending private institutions totaling \$7.5 million.
- Local assistance reductions totaling \$4.2 million.
- State operations reductions in several agencies including Community Colleges and the State Library, among others, totaling \$414,000.

California State Teachers Retirement System Contribution

Expenditures are proposed to decrease by \$567.4 million, a decrease of 49.4 percent over fiscal year 2004-05. The State's contribution to the Defined Benefit Program will be shifted to the school districts or the covered employees, saving the State \$469 million.

- The covered employees will be permitted to discontinue participation in a recently enacted annuity program and realize an increase in take-home pay.

General Government

Expenditures are proposed to decrease by \$702.4 million, a decrease of 41.7 percent over fiscal year 2004-05. This decrease consists of a workload budget decrease in addition to the following major changes:

- **Pension Reform Savings**—Savings of \$296 million are anticipated from two proposals to reform the State's pension contribution amounts. All employees, as their contracts expire, will be required to fund one-half of the future cost of retirement rather than approximately one-fourth of the amounts, saving \$206 million. Employees will be allowed to opt out of the California Public Employees' Retirement System. The State would augment their salaries by one-half the actuarial normal cost, netting a savings of \$90 million.
- **Employee Compensation Costs**—The Budget includes funding for existing Memoranda of Understanding obligations, which result in increased General Fund costs of \$198 million.
- **Other Employee Compensation Savings**—Savings of \$112 million are anticipated from several other employee compensation reforms to be included in new contracts such as a five-day furlough for State employees, elimination of two holidays, a change in how overtime is calculated, and a change in health benefit contributions.
- Reduce the benefits for the Senior Citizen Renters Tax Assistance Program to a level just above the 1998 levels for a savings of \$100.1 million.
- Savings of \$85.5 million are anticipated from the Alternate Retirement Program.
- Reduce funding for the Juvenile Justice Program by \$75 million and transfer the remaining \$25 million

to the Board of Corrections for distribution to local governments.

- Elimination of the Senior Citizens' Property Tax Assistance Program for a savings of \$40.5 million and expansion of the Senior Citizens' Property Tax Deferral Program at \$4.7 million in additional costs. All taxpayers who were previously eligible for the Assistance Program will instead be allowed to defer their taxes.
- Eliminate the Small/Rural Sheriffs' Program for \$18.5 million in savings.
- Reduce funding for Property Tax Administration Grants by \$5.6 million.

Proposition 98

General Fund expenditures are proposed to increase by \$2.409 billion, or 7.1 percent. When property taxes are taken into account, the total Proposition 98 guarantee will increase by \$2.884 billion, or 6.1 percent. This reflects increases in the Proposition 98 guaranteed funding level resulting from increases in General Fund revenues, adjusted for changes in local revenues. This also reflects a decision not to appropriate the \$1.1 billion in 2004-05 and \$1.17 billion in 2005-06 that would otherwise have been required were the Proposition 98 guarantee allowed to run next year as though the 2004-05 suspension had not occurred. The increase will be allocated as follows:

- \$2.080 billion for enrollment growth and cost-of-living, and other minor adjustments.
- \$329.3 million to repay, in part, the outstanding deficit reduction owed as a result of reductions to school district revenue limits made by the prior Administration.

- In addition, the license-exempt child care reimbursement rates will be reduced due to budget constraints for a savings of \$79.3 million.

Structural Reform

The Governor's Budget balances expenditures and available resources (including Economic Recovery Bonds) in 2005-06. Beyond that, however, the State will continue to face a structural budget deficit unless the State's budgeting process is substantially reformed. Therefore, the Governor will propose a variety of reforms designed to lay the groundwork for balanced budgets in the future. The major reforms discussed in this section relate to controlling the State's Budget and modernizing government pension programs.

Living Within Our Means— The Budget Control Proposal

Proposition 58, approved by the voters in March 2004, added for the first time a provision in the California Constitution requiring that the Legislature pass, and the Governor sign, a balanced budget. It also provided for a budget stabilization account to create a reserve to address expenditure and revenue fluctuations in the future. The Governor's Budget Control Proposal builds upon Proposition 58 in several ways, with the overarching principle of increasing the State's ability to enact and implement balanced budgets.

Proposition 58 provides that whenever the Director of Finance advises the Governor that State spending is at a level that is likely to exceed available revenue, the Governor may call a special session of the Legislature to address the imbalance. The Budget Control Proposal will require the Governor to call a special session.

Despite the constitutional requirement to send the Governor a budget by June 15, the Legislature has not done so for the last 18 years. The Budget Control Proposal will provide that whenever the State does not have a budget in effect at the beginning of the fiscal year (July 1), the appropriation levels in the previous year's budget will remain in effect until such time as the Legislature and the Governor enact a new budget. This provision will ameliorate the consequences of the habitual budget stalemates that have occurred in the past while creating an incentive to enact a budget on time. These stalemates have not only interfered with good operation of State programs; they have often cost the State money by delaying the onset of needed reforms.

Under Proposition 58, when the Governor calls a special session to address a budgetary imbalance, the Legislature has 45 days to act. If it fails to do so, it is prohibited from passing any other laws until it has acted to address the budgetary imbalance. The Budget Control Proposal will substantially strengthen Proposition 58 by requiring the State Controller to implement an across-the-board reduction in all State payments (except for debt service and other instances where doing so would violate the federal constitution). These reductions would be implemented only if the Legislature and the Governor have failed to agree on a plan to address the budget imbalance within the 45-day deadline. Furthermore, when a new budget year begins without a budget having been enacted, the analysis to see whether resources cover expenditures will be made immediately, and the across-the-board cuts, if necessary, will be implemented within 30 days, not 45 days of the day the Budget was due.

In addition, the Budget Control Proposal will include a variety of changes to the Constitution to increase the State's ability to enact and implement balanced budgets in the future. These changes include Proposition 98 Reform,

Proposition 42 Reform, Special Fund Reform, and Debt Consolidation.

There is no magic bullet to the State's ongoing structural budget shortfall. Full recovery and a return to a structurally balanced budget will take work and sacrifice by the Administration, the Legislature, local governments, and constituencies around the state. However, the Budget Control Proposal that the Governor is seeking will create the tools and the incentives needed to return California's Budget to true structural balance.

Proposition 98 Reform

Currently, the Legislature can suspend the Proposition 98 guarantee with a bill approved by two-thirds of each house. The Governor's reform proposal would eliminate the ability to suspend Proposition 98. It will also provide for any Settle-Up funds to be provided through a continuous appropriation, to ensure that never again will the State be able to under-fund the schools. Since there can never again be under-funding, the structure of Proposition 98 should be changed to reflect there will be no further use of the maintenance factor. Obligations will not be allowed to pile up from year to year. Settle-Up payments will take place as soon as the relevant year's numbers are known and certified. The guarantee will thus be set at the 2004-05 appropriated level, with increases guaranteed each year as specified in Proposition 98 (generally, a percentage increase equal to the sum of growth in average daily attendance and the State's per capita personal income). Since the State is no longer going to provide make-up of a maintenance factor obligation, in turn the State is no longer going to take advantage of the Test 3 calculation which allowed the State to reduce Proposition 98 when General Fund revenues are lower. Once a Proposition 58 reserve is available, it could help cushion the impact of lower General Fund revenue years. The State will pay its obligation to K-14 under

Proposition 98 as specified in the original two tests, and will not postpone that obligation to future years. All prior sums due for the maintenance factor and Settle-Up will be viewed as a one-time obligation and will be paid over a period of up to 15 years.

Proposition 42 Reform

Proposition 42, enacted by the voters in 2002, requires the State to deposit the proceeds of the sales tax collected on the sale of gasoline into the Traffic Investment Fund (TIF). The TIF can only be used to pay for transportation projects. However, since its enactment, Proposition 42 has been suspended once and partially suspended a second time.

Last year, the Governor reached an agreement with local governments to allow the State to take local property tax funds for two years, and then constitutionally prohibit such taking in the future. The Governor's reform proposal takes a similar approach to sales tax on gasoline. It would allow the State to suspend Proposition 42 for two more years (2005-06 and 2006-07), but removes from the Constitution the ability to suspend after that. All Proposition 42 transfers that are suspended will be treated as loans to the General Fund.

Special Funds Reform

In times of budget crisis, the State has often borrowed money from special funds. This borrowing often imposes hardships on the programs that these funds are intended to support, such as transportation and license-based programs. The budget process reform proposal will prohibit such budget borrowing.

Debt Consolidation

Selected amounts owed by the State to the following accounts will be proposed for repayment over a period of up to 15 years:

- Proposition 42 loans.
- Maintenance Factor and accumulated Settle-up under Proposition 98.
- Unfunded mandates upon local governments.
- Unfunded mandates upon schools (from Proposition 98 funds).

Pension Reform

The escalating costs of public employee pensions are putting pressure on all levels of government in California. Several cities, counties, and school districts around the state face significant threats to their financial solvency in large part due to exorbitant pension agreements. The State's pension costs have increased by \$508 million annually due to the enactment of a single bill—Chapter 555, Statutes of 1999 (SB 400)—that greatly expanded pension benefits at a time when the California Public Employees' Retirement System (CalPERS) was experiencing extraordinary, short-lived investment returns.

In recognition of the rising costs of the CalPERS, the Budget proposes to bargain with employee unions to equalize the employee and employer share of the annual contribution to CalPERS as labor contracts come due, for a General Fund savings of \$206 million in 2005-06. While this will save costs, it falls short of fundamental reform of the public pensions.

Private sector pension plans have moved away from defined benefits toward defined contributions. Defined benefit

plans commit the pension plan to permanent increases, regardless of the ability of the employer and employee to pay for the actuarial costs in the future. They also inhibit employees from changing employers, something that is increasingly common in the private sector job market, because they do not usually allow the employee to move the pension from one employer to another. In contrast, defined contribution plans leave flexibility for the employer and the employee to adjust payments over time and they give the employee a portable pension that can be carried to a new employer.

In order to achieve real reform, not only for State employees' pensions but of all public employee pension systems, the Governor is proposing a constitutional amendment that prohibits the State or any of its political subdivisions from offering defined benefit plans to new employees. Over time, this reform will save billions of dollars to all levels of government and will give employees the kind of portability and affordability that is common in private sector pension plans.

The Economy

The national and California economies improved considerably in 2004. Output of the national economy grew at almost its fastest rate in 20 years. Personal income and taxable sales growth picked up significantly in California, and state exports rebounded. Labor markets strengthened in both the state and the nation. The Budget forecast, as indicated in Figure ECO-01, reflects continuation of these recent trends.

Figure ECO-01

Key Economic Indicators

(Annual Percent Change, except for New Housing)

	2004	Forecast	
		2005	2006
U.S. Real Gross Domestic Product	4.4	3.3	3.0
California Nonfarm Employment	1.0	1.8	1.8
California Personal Income	5.6	5.8	6.0
California Consumer Price Index	2.7	2.9	2.5
California New Housing Units (In Thousands)	210	199	195

Forecast based on data available as of November 2004.

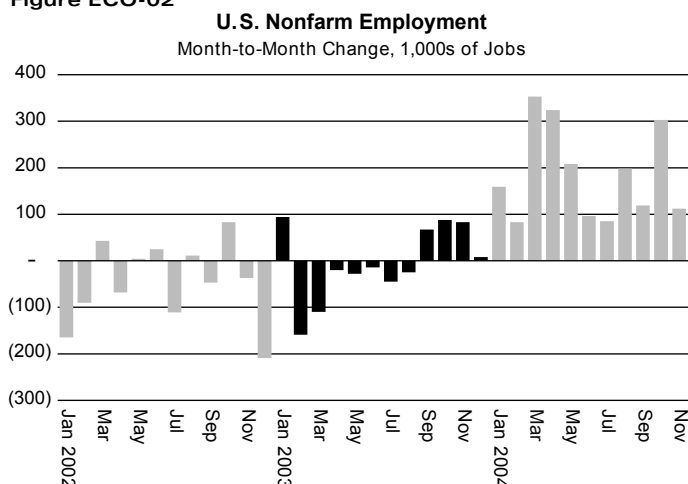
The Nation

Output of the national economy grew more quickly and labor markets improved in 2004 despite soaring energy prices, the waning of the fiscal stimulus of the federal tax

cuts, and tightening monetary policy. The economic recovery from the 2001 recession is now sustainable, based on an increasingly balanced mix of growing consumer spending, business investment, federal government spending, and exports.

- Real gross domestic product growth of 4 percent in the third quarter of 2004 was more than enough to lock in annual average growth of above 4 percent for the year. This growth was driven by strong consumer spending, improved industrial production, rising exports, and a dramatic resurgence in business investment—principally in information technology equipment and software.
- Job creation improved in 2004, although it was lower than what was seen in past economic recoveries when output growth was as strong. The resiliency of the economic recovery was in doubt until the nation started stringing together monthly job gains in September 2003. After losing an average of 5,000 jobs each month in 2003, the nation added a monthly average of about 185,000 jobs during the first 11 months of 2004 (see Figure ECO-02). Strong output growth with only modest job growth signaled a major increase in productivity. Business productivity grew an average of 4.5 percent during the first three quarters of 2004.
- Consumer spending made the greatest contribution to output growth in the third quarter of 2004, expanding by over 5 percent on an annualized basis. Strong yet volatile, motor vehicle sales drove growth of durable goods expenditures above 17 percent. Such strong consumer spending is quite remarkable, given the modest employment growth that accompanied it. As a result, the personal saving rate fell to a record quarterly low, and consumers' debt burden increased from already worrisome levels.

Figure ECO-02



- The continued rebound in business investment played a big role in the strong expansion of the national economy in 2004. Business investment was nearly 14 percent higher in the first three quarters than in the corresponding quarters of 2003. Information processing equipment and software investments led the way, expanding over 17 percent in the first three quarters of 2004.
- Low mortgage interest rates had an outsized impact on real estate and residential construction markets. Home mortgage interest rates below 6 percent sustained robust home sales and, thus, home construction. Sales of existing homes equaled or exceeded 6 million units every month in 2004 through October. New home sales averaged over 1.1 million units in 2004, a nearly 8 percent increase from 2003. This strong demand generated a 5-plus percent increase in new housing starts, resulting in the strongest home building pace since 1978.

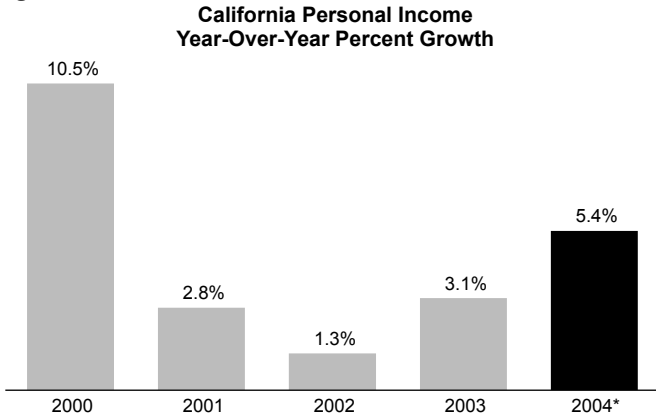
- To be sure, things could turn out better than expected. A steep drop in oil prices would give a considerable boost to the economy. A quick, dramatic improvement in conditions in Iraq would likely make consumers much more confident. Downside risks stem from rising employee benefit costs, high housing prices, and the trade and federal budget deficits. Rapid home price appreciation was the main reason for sustained consumer spending during the 2001 recession. Low savings rates and rising interest rates are expected to dampen real estate gains in the near future.

California

The California economy also strengthened in 2004. Broad economic measures like personal income (See Figure ECO-03) and taxable sales grew more quickly. Exports of made-in-California merchandise posted a good gain after plummeting for three years. Residential construction increased again.

- Personal income was up 5.4 percent from a year earlier in the first half of 2004. A year earlier, personal income was up only 2.4 percent. On this broad measure, the state is doing a little better than the nation.
- Like the nation, California enjoyed better job gains in 2004. In the first 11 months of 2004, California nonfarm payroll employment was 0.9 percent higher than a year earlier. In the first 11 months of 2003, in contrast, nonfarm payroll employment was 0.4 percent lower than a year earlier. The improvement in 2004 was due primarily to better job growth in construction; trade, transportation, and utilities; and the information industries; there were also smaller declines in manufacturing employment. Limiting the improvement in job growth in 2004 were larger declines in government

Figure ECO-03



*First half of 2004

employment and smaller gains in employment in the financial sector.

- The San Francisco Bay Area passed a milestone in the second half of the year when it began to gain jobs for the first time in almost four years. The California recession during the early 2000s was concentrated in the Bay Area. While nonfarm payroll employment remains depressed, the region should contribute to state job growth going forward.
- Made-in-California exports began to turn around in the fourth quarter of 2003 after falling by 26 percent in the preceding three years. In the first three quarters of 2004, exports were 20 percent higher than a year earlier. Increased exports to Mexico, mainland China, Japan, South Korea, France, Singapore, Hong Kong, Taiwan, and the United Kingdom were instrumental in the turnaround. Exports of computer and electronic products, transportation equipment, and nonelectrical machinery accounted for over three-quarters of the gain in total exports.

- Construction activity improved in 2004. Housing permits issuance rose by 6.6 percent in the first 11 months of 2004 from the same months in 2003. Single-family permits were up 9.3 percent, while multi-family permits were up 0.1 percent. Los Angeles and San Bernardino Counties recorded the largest absolute gains, while much of the San Joaquin Valley experienced large percentage increases. Permits were down in the San Francisco Bay Area and the Central Coast.
- The dollar value of private nonresidential construction permits rose by 12.4 percent in the first 11 months of 2004 compared to the same period a year ago. These permits fell by more than a quarter from 2000 to 2003. New permits for retail and office space and alterations and additions contributed most to the rebound in 2004.
- California housing markets continued to set new records in 2004, with sales up 4.1 percent and median prices up 20.9 percent in the state in the first 11 months. However, during the July-to-November period, sales were off by 1.6 percent compared to the same five-month period a year ago. Year-over-year price gains remained stable at the 19 to 23 percent level all year.

Revenue Estimates

California revenues began recovering in 2003 and showed solid growth in 2004. The outlook for 2005 and 2006 is for continued gains. Therefore, revenue expectations have improved from what was projected at the time the 2004 Budget Act was enacted. Since that time, the General Fund revenue forecast for major taxes and licenses has increased by \$1.2 billion for the past and current years combined, with total 2004-05 revenues and transfers estimated at \$78.2 billion. In addition, a year-over-year increase of 6.8 percent in revenues, or \$5.3 billion, to \$83.2 billion is expected for 2005-06. The revenue increase includes significant gains in the three major taxes: personal income tax, sales tax, and corporation tax.

Major Revenue Sources

Overall, General Fund revenues and transfers represent 78 percent of total revenues. The remaining 22 percent are special fund revenues dedicated to specific programs. The three largest revenue sources (personal income tax, sales tax, and corporation tax) account for about 77 percent of total revenues and 92 percent of General Fund revenue.

Personal income tax revenues are projected to be \$39.5 billion in 2004-05 and \$42.9 billion in 2005-06. The key

factor underlying this forecast is that the general State economy strengthened in 2004 and continued growth is expected in 2005 and 2006.

Proposition 63, passed by voters in November 2004, imposed a personal income tax surcharge of 1 percent on taxpayers' taxable income above \$1 million. The surcharge will be levied beginning January 1, 2005, and the proposition stipulated that the revenue resulting from the surcharge would be transferred to a special fund (the Mental Health Services Fund) dedicated to funding county mental health services and program expenditures. Pursuant to the Proposition, the estimated revenue from the additional tax is \$254 million in 2004-05 and \$683 million in 2005-06. The actual amount collected from the additional tax will not be known, however, until the spring of 2007, when 2005 tax return data are available. (See the Health and Human Services Section for a discussion on the mental health services programs that will be funded by the surcharge.)

Sales and use tax revenue is forecast at \$25.2 billion in 2004-05 and \$26.9 billion in 2005-06. Taxable sales grew by 4.3 percent in 2003, and are expected to increase by 5.7 percent in both 2004 and 2005.

Current law specifies that certain State revenues from the sales tax on gasoline and diesel fuel sales be transferred to the Public Transportation Account (PTA). The Governor's Budget proposes to maintain the base level of transfers to the PTA, but specifies that any excess sales tax revenues on gasoline, which would otherwise be designated as PTA "spillover," be credited to the General Fund for 2005-06. This is expected to increase General Fund revenues by \$216 million in 2005-06. This follows the 2004 Budget Act provision that transfers "spillover" amounts of \$140 million to the Traffic Congestion Relief Fund and retains the remainder of approximately \$128 million for the General Fund.

Beginning on July 1, 2004, a new, temporary 0.25 percent sales tax rate was imposed, with revenues dedicated to repayment of Economic Recovery Bonds. Once these bonds are repaid, this tax will end and the local government general purpose sales tax rate will return to 1 percent, from 0.75 percent. Revenues from this 0.25 percent sales tax rate are estimated at \$1.167 billion in 2004-05 and \$1.358 billion in 2005-06.

Corporation tax revenues are expected to total \$8.7 billion in 2004-05 and \$9 billion in 2005-06. Taxable profits are estimated to increase by 16.8 percent in 2004-05 and 7.1 percent in 2005-06.

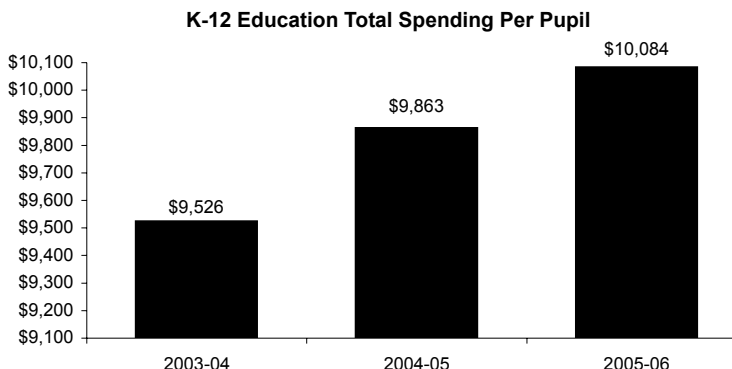
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K-12 Education — Proposition 98

Overview

Despite the fiscal challenges facing California, the kindergarten through 12th grade (K–12) education budget augments core instructional programs through an increase of \$1.8 billion in total revenues to public schools. Total 2005-06 K–12 funding from all sources is estimated to be \$61.1 billion. As a result, total per-pupil expenditures will exceed \$10,000 for the first time. Total per-pupil expenditures from all sources are projected to be \$9,864 in fiscal year 2004-05 and \$10,084 in fiscal year 2005-06 (see Figure K12-01).

Figure K12-01



Proposition 98 Guarantee

The 2004 Budget Act reflected Proposition 98 appropriations at a rebased level approximately \$2 billion less than would have otherwise been required to meet the constitutionally guaranteed funding level for 2004-05. Subsequently, the guaranteed funding level for 2004-05 has increased by over \$1.1 billion, primarily due to increases in General Fund revenues. However, given the size of the State's budget shortfall and to avoid significant reductions in programs critical to the health and well-being of the State's most vulnerable children and families, the Administration proposes to maintain 2004-05 expenditures at the Budget Act level, as adjusted for changes in local revenues and average daily attendance (ADA) growth. This proposal results in savings of \$1.1 billion in 2004-05 and an additional \$1.17 billion in 2005-06.

Total 2003-04 Proposition 98 funding was \$46.3 billion, of which the General Fund share is \$30.5 billion. Total 2004-05 Proposition 98 funding is \$47.1 billion, which reflects a 1.7 percent increase over 2003-04. The General Fund share is \$34.1 billion in 2004-05. These funding levels have been adjusted for changes in attendance and costs for apportionment programs, and no discretionary reductions to program levels are proposed. Total 2005-06 Proposition 98 funding is proposed at \$50 billion, which reflects a 6.1 percent increase over 2004-05. The General Fund comprises approximately 73 percent, or \$36.5 billion of total proposed Proposition 98 funding (see Figure K12-02). These totals include funding for K-12 and community colleges.

Proposition 98 per-pupil spending for 2005-06 will increase to an estimated \$7,374, which is \$362 above the 2004-05 level and \$357 above the 2003-04 level.

Figure K12-02

Proposition 98
(Dollars in thousands)

Appropriations	2003-04	2004-05	2005-06
K-12 Education	\$41,905,167	\$42,279,256	\$44,804,698
Community Colleges	4,370,516	4,803,936	5,162,922
Total	\$46,275,683	\$47,083,192	\$49,967,620
<i>State General Fund</i>	<i>30,521,723</i>	<i>34,123,805</i>	<i>36,532,334</i>
<i>Local Revenue</i>	<i>15,753,960</i>	<i>12,959,387</i>	<i>13,435,286</i>

Achieving High Academic Standards Through Healthy and Effective Learning Environments

In communities across the state, teachers, principals, and school administrators are working to improve pupil achievement and the Administration is committed to equipping them with tools to help them succeed. The Administration aims to reduce bureaucracy and make more resources available to serve students in schools, ensure that schools that are failing, fiscally and academically, are provided the necessary accountability and training to create healthy and successful schools, and provide more opportunities for students in school.

Career Technical Education Reform—The Administration proposes a series of reforms to ensure that all students have educational opportunities that lead to successful employment in a variety of career fields. The Career Technical Education Reform plan builds upon successful programs in the K-12 and community college systems, expands course offerings, and helps meet the demand for career technical instruction. To expand the use and effectiveness of career technical education in California, the Administration's approach supports the following:

- Increasing the knowledge and information students and faculty have regarding vocational and technology-related careers.
- Expanding the capacity of K–12 schools and community colleges to provide more coordinated instruction to students in these career fields.
- Revising teacher requirements to ensure sufficient numbers of well-prepared faculty are available to provide this cutting-edge instruction.
- Designing system measures to evaluate a school's performance in preparing students for careers.
- Supporting the Higher Education Compact's goal to have the University of California and the California State University review and accept high school courses that integrate academic and career-technical course content.

Fitness and Nutrition Initiative—Student fitness not only reduces health and stress risks, but also promotes self-esteem and academic achievement. Additionally, young people who learn how to stay healthy are less likely to get involved with drugs or alcohol. As part of the Governor's California Obesity Initiative to improve the health of California's children, the Administration proposes the following:

- Improve the nutritional quality of food and beverages available in schools.
- Increase opportunities for physical fitness and activities in schools.
- Seek legislation to establish a program to make fresh fruits and vegetables available to students in schools.

Accelerated English Language Acquisition

Program—The Administration proposes to establish a new Accelerated English Language Acquisition Program to

provide targeted reading instruction to English learners in 4th through 8th grade. This proposal, based upon the successful Reading First Program, will combine professional development and school-site support to increase reading acquisition. This program will provide additional support in English language acquisition and improved reading skills that are critical to student success. The Governor's Budget proposes \$57.6 million for this program.

Creating Alternatives for Failing Schools—The federal No Child Left Behind (NCLB) Act of 2001 has focused attention on the nation's lowest performing schools. Under NCLB, when schools fail to meet benchmarks of academic achievement they are designated "Program Improvement Schools." Currently, there are over 1,600 California schools in Program Improvement. This initiative is a two-pronged approach to address the needs of our failing schools by providing timely and meaningful assistance. Specifically, the Administration proposes that the State Board of Education (SBE) take action in failing schools by either of the following:

- Converting them into charter schools. Public charter schools provide an alternative to the traditional public school by allowing greater fiscal and instructional flexibility. In return, the charter school is held accountable for improving the academic achievement of its students.
- Assigning School Recovery Teams to manage the schools. The main focus of the teams will be to manage the school. Teams will be assigned to take over the duties of the existing principal, assistant or vice principals, academic deans, district coordinators, designated reform coordinators, and teacher leaders.

In addition to the initiatives proposed above, the Governor's Budget includes \$271.4 million for the Immediate Intervention Underperforming Schools Grant and the High Priority

Schools Grant programs which are State programs designed to improve failing schools.

Alternative Authorizers for Charter Schools—In order to allow for the establishment of charter schools where they are most needed, the Administration will introduce legislation to allow entities such as colleges and universities to be designated, subject to authorization by the SBE, as alternative regional authorizers of charter schools.

Local Control: Achieving Academic Success—The Secretary for Education (OSE) will pursue greater local control through the creation of the California Local Education Accountability Reform (CLEAR) program, which will give individual schools additional flexibility to create effective educational strategies in their quest of reaching California's high academic standards. The CLEAR program will be established as a voluntary pilot program. The program will place more control of school resources at each school site and encourage the active participation of parents and teachers all focused on one goal, increasing student academic achievement.

School Size Reduction—The Administration seeks to convert the State's largest elementary, middle, and high schools into smaller learning environments or schools-within-schools. These smaller learning environments will provide a more effective learning experience and the opportunity for students and teachers to develop closer relationships. The Administration intends to pursue these changes through the School Facility Program and also by making resources available for technical assistance and planning purposes.

Improving Fiscal Health—The Administration will pursue legislation to establish the Chief Business Officer Training Program. Over the next three years, this program will provide training to over 1,000 school district and county office of education chief business officers in key elements

of school fiscal management. The program's goal is to help ensure that fiscal staff in districts and county offices of education have the skills and knowledge necessary to effectively manage the significant resources provided for K-12 education. The Governor's Budget proposes \$1.1 million from the Proposition 98 Reversion Account to support this program.

Categorical Reform—The Administration proposes reducing the number of State-funded categorical programs through the expansion of block-grant funding for professional development programs and reforming the charter school block grant to increase the predictability of funding for charter schools.

- The following programs, Teacher Credentialing Block Grant, Peer Assistance Review, Bilingual Teacher Training, and Teacher Dismissal Apportionment, are added to the new Professional Development and Teacher Credentialing Block Grant for total funding of \$361.7 million.
- The Governor's Budget proposes to eliminate the linking of the Charter Schools Categorical Block Grant to specific categorical programs and instead establishes a base funding level adjusted annually to reflect charter school enrollment growth and cost of living adjustments. The Budget includes \$62 million for this block grant, or an increase of \$10 million over the current year.

Funding for the Mathematics and Reading Professional Development and the Principal Training programs will be maintained outside of the Professional Development and Teacher Credentialing block grants, as the purpose of these programs is to provide specific training to teachers and administrators during a limited time period.

- The Governor's Budget provides \$31.7 million for the Mathematics and Reading Professional Development Program to continue professional development activities in reading and math academic content standards and use of standards-aligned instructional materials.
- The Governor's Budget provides \$5 million for the Principal Training Program to provide principals and vice principals with training in instructional standards and effective school management techniques.

State Child Care Programs

The Governor's Budget provides a total of \$3.1 billion for the various child care programs administered by the Department of Education, the Department of Social Services, and the California Community Colleges. General Fund spending decreases by \$27.4 million, while federal fund spending increases by \$33.9 million. These adjustments reflect proposed reforms with estimated savings of \$94.8 million Proposition 98 General Fund, caseload changes, the provision of statutory growth and cost of living (COLA) adjustments to non-caseload-driven programs, and other miscellaneous adjustments including those related to one-time funding.

Increasing Quality and Equity in Access—The 2005-06 Governor's Budget includes various reforms that will facilitate equitable family access to care and establish a child care system that acknowledges and promotes high quality child care.

- The Administration proposes to reduce license-exempt child care reimbursement levels. In doing so, the Administration also will create financial incentives for child care providers, both licensed and license-exempt, to raise and demonstrate the quality of their services by seeking health and safety training, obtaining a child care license or teaching permit, enhancing their

knowledge of early childhood development, raising scores on environmental rating scales, and becoming accredited. The Governor's Budget includes federal funding for environmental rating scale evaluations and for training of environmental rating scale evaluators.

- The Administration proposes to immediately implement regulations to ensure that reimbursement rates in State-subsidized child care programs are reasonably tied to the rates paid by non-subsidized families.
- The Administration proposes to ensure that the neediest families have equal access to subsidized child care regardless of whether they are current or former CalWORKs recipients or have never received CalWORKs assistance.
 - Families receiving CalWORKs child care who have been off aid for more than two years will be transferred into the general (non-CalWORKs) alternative provider (AP) program, along with the associated funding to expand the general AP program.
 - Families receiving CalWORKs child care who have been off aid for two years or less will immediately put their name on a waiting list for the general AP program and will be allowed to continue to receive CalWORKs child care for up to four years, thus enabling them enough time to obtain a slot in the general AP program.
 - Families who are still on aid will continue to receive subsidized child care until they leave aid, their names will be added to the waiting list concurrently with earned income while on aid, and they will be assured a maximum of three additional years of CalWORKs child care after they leave cash aid to allow them time to find a slot in the general AP program.

- The Governor's Budget includes \$7.9 million for counties to develop and maintain centralized child care eligibility lists.
- Beginning in 2005-06, income eligibility for child care programs will be based upon the Federal Poverty Level. This change will provide greater consistency between California's child care programs and other State and national health and human services programs.

K-12 Spending Changes

K-12 Enrollment Growth—The Governor's Budget provides a \$394.7 million increase to fully fund statutory ADA growth: \$245.9 million for revenue limit apportionments, \$29.7 million for child care and development, \$5.8 million for K-3 class size reduction, \$31.4 million for Special Education, and \$81.9 million for other categorical programs. For the current year, total K-12 ADA is estimated to be 6,016,000. For the budget year, total K-12 ADA is estimated to be 6,063,000. This total reflects ADA growth of 47,000, or 0.8 percent over the current year.

Cost of Living Adjustment—The Governor's Budget fully funds an estimated \$1.7 billion 3.9 percent statutory COLA increase: \$1,222.1 million for revenue limits, \$50.8 million for child care and development, \$14 million for class size reduction, \$156.6 million for Special Education, and \$206.4 million for various categorical programs.

Deficit Factor Reduction—The Governor's Budget proposes to repay \$328 million, almost half, of the outstanding deficit factor owed as a result of reductions to school revenue limits (general purpose funding for schools) made by the prior Administration.

Special Education—In addition to the funding increases for growth and COLA identified above, the Governor's Budget reflects an increase of \$65.1 million in federal funds

for special education programs, of which \$24.8 million is passed through to local education agencies.

State Department of Education—The Governor's Budget proposes \$301.7 million (\$119.9 million General Fund and \$181.8 million other funds) and 2,645.2 positions for state operations in 2005-06. This represents an increase of \$1.2 million General Fund and 15 positions above revised 2004-05. This primarily reflects miscellaneous baseline adjustments such as employee compensation, rent, and price increases. General Fund increases also include \$203,000 for the adoption of instructional materials. Additional federal funds also are provided, including \$963,000 for State Special School transportation costs, \$832,000 for additional staff to monitor Non-Public Schools and Licensed Children's Institutions, and \$68,000 for additional staff to support local financial reporting.

Proposition 98 Reversion Account—One-time funding totaling \$138.6 million will be appropriated as follows:

- \$100 million for school facility emergency repairs, consistent with the Williams agreement.
- \$20 million for Career Technical Education Curriculum, funded within the community college system.
- \$10 million for CalWORKs child care base adjustments.
- \$4.9 million for the Sunnyvale desegregation deficiency.
- \$2.3 million for a shortfall in funding for the STAR assessment.
- \$1.1 million for school business officer training.
- \$354,000 for shortfalls in child nutrition funding in fiscal years 1999-00, 2000-01, and 2003-04.

California State Library

The Governor's Budget proposes \$71.6 million (\$45.4 million General Fund and \$26.2 million other funds) and 202.4 positions for the California State Library (CSL) in 2005-06. This represents a reduction of \$3 million (\$3.2 million General Fund) from the revised 2004-05 Budget. This reflects:

- A \$329,000 General Fund augmentation for the acquisition and implementation of a replacement automated library system to support the CSL's Braille and Talking Book Library operations.
- A \$170,000 General Fund reduction in state operations. The CSL will have the flexibility to implement the state operations reduction through layoffs, hiring freeze, procurement reductions, or other administrative means as it may choose.
- A \$3.3 million General Fund reduction in local assistance. The local assistance reduction includes a \$2.2 million reduction to the Public Library Foundation program, an \$828,000 reduction to the Library Development program, and a \$276,000 reduction to the English Acquisition program.

California Commission on Teacher Credentialing

The Governor's Budget proposes \$57 million (\$31.8 million General Fund and \$25.2 million other funds) and 160.3 positions for the Commission on Teacher Credentialing (CTC) in 2005-06. This represents a reduction of \$3.3 million (\$3.5 million General Fund) and 6 positions from the revised 2004-05 Budget. The General Fund reduction is due to removal of \$3.5 million in one-time funding from the pre-intern program.

Streamlining Teacher Credentialing

- The Teacher Credentialing Service Improvement Project allows colleges and universities to submit credential applications electronically and allows applications to be renewed online. To reflect the decreased staff time required to process applications, a reduction of \$600,000 for 6 positions is proposed from the Teacher Credentials Fund.
- The Administration proposes that all public and private colleges and universities that have teacher preparation programs that have been accredited by the CTC be responsible for approving and electronically submitting all credentialing applications for their students. This will result in a significant workload savings for CTC and better ensures that applications from new teachers are processed in a timely manner, thus allowing them to enter the classroom as soon as possible.

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Higher Education

Overview

Recognizing that the institutions for higher education are integral to California's economic well-being, the Administration is committed to fulfilling the Higher Education Compact that was signed in spring 2004 with both the University of California (UC) and the California State University (CSU) to provide funding stability and preserve educational quality over the next six fiscal years in exchange for improved accountability in a variety of key student performance indicators. The Compact provides a long-term resource plan for UC and CSU that addresses base budget allocations, enrollment, student fees, and other key program elements through 2010-11. In exchange for this long-term stability, the segments committed to improving or preserving successes in student and institutional outcomes in numerous program areas including program efficiency, utilization of systemwide resources, and student-level outcomes. The 2005-06 Governor's Budget marks the first year of funding under that agreement.

Despite the severe constraints on the State's Budget, and the need to revisit the funding provided by Proposition 98 for K-14 education, the Governor will fully fund

the commitments he undertook in the Higher Education Compact. Additionally, the Budget continues to invest substantial additional funding in the California Community Colleges (CCC) and California Student Aid Commission (CSAC) to ensure access to quality higher education and training is available for all qualified students. As shown in Figure HED-01, the Budget contains \$17.7 billion total funds and \$11.9 billion General Fund for all segments of Higher Education. These amounts represent a 5.3 percent increase in total funds and 6.9 percent increase in General Fund over the revised 2004-05 Budget.

Figure HED-01

**Higher Education Funding
Total and General Funds**
(Dollars in Millions)

	<u>2003-04</u>	<u>2004-05</u>	<u>2005-06</u>	<u>One-Year Change Amount</u>	<u>Percent</u>
University of California^{1/}					
Total Funds	\$4,516.1	\$4,533.4	\$4,780.8	\$247.4	5.5%
General Fund	\$2,868.1	\$2,708.8	\$2,806.3	\$97.5	3.6%
California State University^{1/}					
Total Funds	\$3,651.4	\$3,649.9	\$3,838.8	\$188.9	5.2%
General Fund	\$2,625.7	\$2,496.7	\$2,607.2	\$110.5	4.4%
Community Colleges					
Total Funds	\$6,712.8	\$7,560.0	\$7,941.0	\$381.0	5.0%
General Fund & P98 ^{2/}	\$4,507.0	\$5,034.4	\$5,407.8	\$373.4	7.4%
Student Aid Commission					
Total Funds	\$688.6	\$748.5	\$793.1	\$44.6	6.0%
General Fund	\$672.1	\$589.4	\$745.5	\$156.1	26.5%
Other Higher Education^{3/}					
Total Funds	\$199.4	\$304.5	\$329.6	\$25.1	8.2%
General Fund	\$179.6	\$277.7	\$302.6	\$24.9	9.0%
Total Funds	\$15,768.3	\$16,796.3	\$17,683.3	\$887.0	5.3%
General Fund	\$10,852.5	\$11,107.0	\$11,869.4	\$762.4	6.9%

^{1/} For purposes of this table, expenditures for the University of California and California State University have been adjusted to include the offsetting general-purpose income. This provides consistency in comparing magnitudes and growth among the various segments of education.

^{2/} For purposes of comparing with UC and CSU General Fund, CCC includes property tax revenue as a component of the State's obligation under Proposition 98.

^{3/} Other Higher Education includes the California Postsecondary Education Commission, Hastings College of the Law, and General Obligation Bond Interest and Redemptions for UC, CSU, and Hastings.

Access

- Pursuant to the Compact, the Budget provides 2.5 percent growth for UC and CSU. This growth provides increases of 5,000 students for UC and over 8,000 students for CSU and is in addition to the augmented student enrollment provided in the final 2004 Budget Act. Total funded Full-Time Equivalent Students (FTES) for 2005-06 at UC and CSU are respectively proposed at 205,976 and 332,233.
- For the CCC, the Budget provides 3 percent growth in credit and noncredit instruction. This provides an increase of 34,000 additional students for a total of approximately 1,177,000 FTES.

Student Fees

- The Compact includes a long-term student fee policy that calls for increases to undergraduate student fees based on the rise in California per capita income with flexibility to increase no more than 10 percent in any year, based on fiscal circumstances. Therefore, UC and CSU have adopted an 8 percent increase for 2005-06 undergraduate student fees. Consistent with the Compact, the segments will dedicate a substantial portion of the fee increases for financial aid for needy students.
- The Compact also provides that UC and CSU make progress toward the Administration's policy expectation that graduate fees be 50 percent higher than system-wide undergraduate fees to better reflect the higher cost of instruction and value of graduate education to the student. Therefore, consistent with the Compact, both UC and CSU have adopted a moderate 10 percent student fee increase for graduate students for 2005-06.
- Fees at California's four year segments remain low in comparison to other public institutions. Figure HED-02

shows that UC's 2004-05 undergraduate fees are nearly 14 percent lower than the average of other national comparative institutions, while CSU's 2004-05 undergraduate fees are almost 48 percent lower,

Figure HED-02 Higher Education Fees

■ 2004-05 Fee Comparison

	UC ^{a/}				Other Public Institutions (2004-05)		
	2004-05 Ed/Reg Fee	2004-05 Total Fee	2005-06 Ed/Reg Fee	2005-06 Total Fee	Average	Highest	Lowest
Undergraduate	\$5,684	\$6,312	\$6,141	\$6,769	\$7,341	\$8,722	\$5,907
Graduate	\$6,269	\$7,875	\$6,897	\$8,556	\$10,138	\$13,585	\$8,310
CSU ^{b/}							
Undergraduate	\$2,332	\$2,916	\$2,520	\$3,102	\$5,656	\$8,869	\$3,034
Graduate (non-teacher prep.)	\$2,820	\$3,404	\$3,102	\$3,684	na	na	na
Graduate (teacher prep)	\$2,707	\$3,291	\$2,922	\$3,504	na	na	na
CCC ^{c/}							
Full-Time Undergraduate Student	\$780		\$780		\$2,155	\$4,771	\$949
Bachelor-Degree Holders	\$780		\$780		na	na	na

a/ UC's 2005-06 fees are anticipated to increase by 8 percent for undergraduate and 10 percent for graduates, and consist of an undergraduate education fee of \$6,141 (\$6,897 for graduate students), which includes a registration fee of \$735, and an average campus-based fee of \$628 for undergraduate students and \$1,659 for graduate students.

b/ CSU's 2005-06 fees are anticipated to increase by 8 percent for undergraduates, 8 percent for teacher preparation graduates, and 10 percent for other graduates, and include an undergraduate education fee of \$2,520 (\$3,102 for non-teacher preparation graduates and \$2,922 for teacher preparation graduates) and a campus-based fee of \$582 for both undergraduate and graduate students.

c/ Comparison data for other states reflect 2003-04 data.

■ 2004-05 Professional School Fee Comparison:

	UC ^{d/}	Other Public/Private Institutions		
		Average	Highest	Lowest
Law	\$20,826	\$27,723	\$36,490	\$14,577
Medicine	\$21,388	\$29,044	\$37,947	\$21,267
Business Administration	\$21,279	\$30,623	\$41,812	\$9,735

d/ Professional fees reflect base fee levels, only.

■ Percent of Instruction Paid by Students:

	2004-05	2005-06
UC	32.9%	31.6%
CSU	20.7%	21.8%
CCC	16.5%	15.9%

and these calculations exclude the further benefit of Cal Grants that are used by many students in these systems.

- For the CCC, the Budget proposes no additional increase in fees for the 2005-06 fiscal year. While fees for the community colleges have increased in each of the last two years, California's fees remain the lowest in the nation and more than 63 percent lower than the national average (also see Figure HED-02). However, given the Administration's commitment to broad access for all qualified students, the Budget recognizes the need to minimize barriers and maintain the low student fees.

Higher Education Initiatives

The Governor encourages more involvement of the college and university systems to utilize their capacity to assist K–12 schools in two major areas where improvement is needed. Those areas include reinvigorating the relevance and availability of career technical education so that pathways for success are available for all students, and to improve the supply of highly qualified math and science teachers to ensure California is able to maintain its leadership in industries requiring employees with high levels of those necessary skills in order to propel our economy in the future.

Economic Development and Career Technical Education Reform—As also discussed in the K–12 section, the Administration proposes the following funding increases and reforms that affect higher education segments:

- The Budget proposes \$20 million for the Community College Economic Development program to create new articulated courses between K–12 and community colleges by building on the Economic Development program's successful integration with business and

emerging industries. By aligning career-technical education curriculum between K–12 and community colleges to more targeted industry-driven programs through the existing Tech Prep 2+2 model, the State can successfully expand the career options for students.

- The Administration proposes to reform K–12 and community college instructor credentialing by creating consistent requirements between both segments that will ensure a sufficient supply of the most knowledgeable instructors within each career sector.
- The Administration proposes to exclude career-technical education courses offered by community colleges from application of the 75 percent full-time faculty requirement. This change will ensure districts can hire sufficient faculty who have the most up-to-date knowledge of current entry level skill standards, which is not always available from tenured full-time faculty.
- Finally, the Higher Education Compact reflects commitments by both UC and CSU to support expansion of career technical education courses by ensuring articulation of high school career preparatory courses that integrate academic 'a–g' requirements, and through other activities.

Increasing the Supply of Highly Qualified Math and Science Teachers—A critical shortfall exists in California schools in the number and quality of K–12 teachers in science and math. In order to ensure that California remains economically competitive, the Compact calls for the UC to work in collaboration with the CSU to develop a major initiative to improve the supply and quality of science and math teachers in the state. In this regard, the higher education segments will undertake the following activities:

- The UC and CSU intend over the next five years to expand significantly the number of science and

mathematics teachers being educated. This expansion will be included as part of the UC and CSU's planned enrollment growth.

- Also, new efforts will be pursued, in conjunction with CSU efforts currently under way or in development, to ensure that the majority of new teachers will have the skills necessary, particularly in the areas of special education and English and language arts, to meet the demands of rigorous state standards and that continue to improve the quality and efficiency of teacher training sufficient to meet demand.

University of California

The Governor's Budget provides total funding of \$4.781 billion for the UC, including \$2.806 billion General Fund. These amounts reflect an increase of 5.5 percent in total funds and 3.6 percent in General Fund over the revised 2004-05 Budget levels of \$4.533 billion in total funds and \$2.709 billion General Fund.

In accordance with the Compact, the Governor's Budget proposes the following adjustments:

- \$76.1 million increase (3 percent) for basic budget support consistent with the Compact.
- \$37.9 million increase (2.5 percent) for enrollment growth consistent with the Compact.
- \$14 million one-time funds for costs associated with making UC Merced operational in 2005-06 for a total funding level of \$24 million.
- \$3.8 million reduction by eliminating the one-time General Fund legislative augmentation for the Multi-Campus Research Units for Labor Studies. Both this reduction and the following are necessary to bridge the gap between expenditures and projected revenues.

- In addition to the amount above, the 2004 Budget Act was augmented by \$26.5 million for enrollment growth and outreach programs beyond the obligations of the Compact. The Budget reduces \$17.3 million of this amount and provides UC with the discretion to determine how to balance the needs for outreach and student enrollment funding. The Administration will work with the UC to develop performance measures to evaluate the cost effectiveness of all outreach programs.

California State University

The Governor's Budget provides total funding of \$3.839 billion for the CSU, including \$2.607 billion General Fund. These amounts reflect an increase of 5.2 percent in total funds and 4.4 percent in General Fund over the revised 2004-05 Budget levels of \$3.65 billion in total funds and \$2.497 billion General Fund.

In accordance with the Compact, the Governor's Budget proposes the following adjustments:

- \$71.7 million increase (3 percent) for basic budget support consistent with the Compact.
- \$50.8 million increase (2.5 percent) for enrollment growth consistent with the Compact.
- \$44.4 million increase for baseline retirement contribution increases.
- The 2004 Budget Act was augmented by \$37.7 million for enrollment growth and outreach programs beyond the obligations of the Compact. The Budget reduces \$7 million of this amount and provides CSU with the discretion to determine how to balance the needs for outreach and student enrollment funding. This is necessary to bridge the gap between expenditures and projected revenues. The Administration will work with

the CSU to develop performance measures to evaluate the cost effectiveness of all outreach programs.

Hastings College of the Law

The Governor's Budget provides total funding of \$35.4 million for Hastings in 2005-06, including \$8.4 million General Fund. These amounts reflect an increase of 1.3 percent in total funds and 3 percent in General Fund over the revised 2004-05 Budget levels of \$34.9 million in total funds and \$8.1 million General Fund.

- Consistent with the Compact, the Governor's Budget includes a 3 percent General Fund increase of \$244,000 for basic budget support.

California Community Colleges

The Governor's Budget proposes over \$7.9 billion for the CCC through a combination of State, local property tax and federal revenues, student fees, and other local miscellaneous revenues. Of this amount, \$5.4 billion from Proposition 98 sources, including local property taxes, and non-Proposition 98 General Fund are provided. These figures reflect a 5 percent increase in total funds and a \$373.4 million or 7.4 percent increase from Proposition 98 and non-Proposition 98 General Fund sources.

Significant augmentations and other changes to the community colleges budget include:

- \$136.7 million increase (3 percent) for enrollment growth. This level of funded growth exceeds the 1.89 percent change in adult population, which is the current statutory index for system growth.
- \$195.5 million (3.93 percent) cost of living adjustment for general-purpose apportionments (\$184.5 million)

and categorical programs providing essential services to special populations (\$11.1 million).

- \$31.4 million is set aside for potential restoration to community college apportionments, pending the outcome of a district-specific accountability mechanism under consideration by a Board of Governor's workgroup pursuant to Chapter 581, Statutes of 2004 (AB 1417).
- \$20 million for the Economic Development program in context of the Governor's Career Technical Education initiative as discussed previously.
- \$137,000 reduction to state operations as part of a larger non-Proposition 98 General Fund reduction necessary to bridge the gap between expenditures and projected revenues.

Financial Aid Programs

The Governor's Budget provides total local assistance funding of \$793.1 million for CSAC in 2005-06, including \$745.5 million General Fund. These amounts reflect an increase of 6 percent in total funds and 26.5 percent in General Fund over the revised 2004-05 budget levels of \$748.5 million in total funds and \$589.4 million General Fund. The Governor's Budget proposes the following significant baseline adjustments for CSAC financial aid programs:

- \$146.5 million General Fund backfill to replace the use of one-time surplus monies from the Student Loan Operating Fund (SLOF) that were used to support financial aid programs in 2004-05.
- An increase of \$44.8 million for the Cal Grant Program, over the revised current year estimate which reflects

General Fund savings of a similar amount that CSAC expects for 2004-05.

- \$6.8 million General Fund for growth in the Assumption Program of Loans for Education (APLE).

Additionally, the Budget proposes the following policy adjustments:

- \$200,000 General Fund to implement an initial cohort of National Guard APLE awards pursuant to Chapters 549 and 554, Statutes of 2004. These warrants provide up to \$11,000 for reimbursement of college loans in exchange for completing service enlistments in the National Guard.
- \$35 million one-time increase in SLOF monies to support CSAC financial aid programs in 2005-06, thereby generating an equivalent General Fund savings.
- \$7.5 million reduction by reducing the maximum new Cal Grant awards for students at private colleges and universities from \$8,322 to \$7,449. This reduction is necessary to bridge the gap between expenditures and projected revenues.

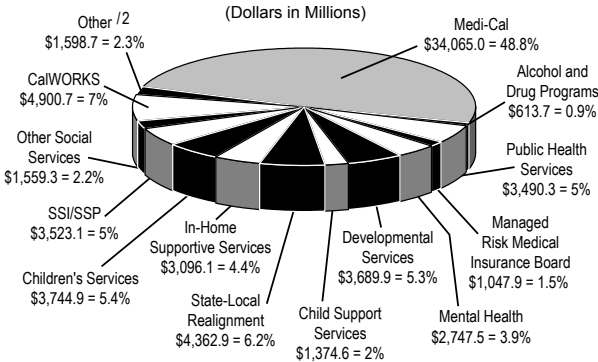
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Health and Human Services

The Health and Human Services Agency (HHS) oversees an array of departments and boards that provide essential services to many of California's most vulnerable and at-risk residents.

For 2005-06, expenditures for all HHS budgets total \$69.8 billion in combined State and federal funds. This includes expenditures for approximately 32,500 State

Figure HHS-01
Health and Human Services Proposed 2005-06 Funding ^{/1}
All Funds



^{/1} Totals \$69,814.4 million for support and local assistance. This figure includes reimbursements of \$5,409.6 million and excludes county funds that do not flow through the State budget and enhanced federal funding.

^{/2} Includes the Health and Human Services Agency, Department and Commission on Aging, Departments of Rehabilitation and Community Services and Development, Office of Statewide Health Planning and Development, State Independent Living Council, Emergency Medical Services Authority, California Children and Families Commission, State Council and Area Boards on Developmental Disabilities, and setasides.

employees. Figure HHS-01 displays expenditures for each major program area. The 2005-06 totals exceed the total revised 2004-05 Budget by \$44.1 million, which, after accounting for population growth and the general Consumer Price Index, constitutes an increase of less than 1 percent.

The 2005-06 General Fund workload budget for the HHSA of \$27.8 billion is offset by savings of \$1.2 billion resulting from policy-based decisions. These savings reflect the need to produce a balanced, responsible budget. The decisions behind these savings reflect the Governor's commitment to protect the developmentally disabled and advance the goal that all of California's children have health insurance.

Health and Human Services Initiatives

The Governor's Budget proposes a number of reforms and initiatives that reflect the imperative to maintain essential services to our State's most vulnerable and at-risk residents and to better manage and control program costs. These initiatives reflect an emphasis on priority populations, such as uninsured children who are eligible, but not enrolled in Medi-Cal or the Healthy Families Program, and priority policy areas, such as obesity prevention and mental health, that are critical to promoting the health and well-being of the people of California.

- **Medi-Cal Program Redesign**—The Governor's Budget is proposing a redesign of select components of Medi-Cal to increase efficiency and effectiveness for beneficiaries and providers, improve health care outcomes, and provide for the long-term financial viability of the program.
- **California Obesity Initiative**—The Governor's Budget includes approximately \$6 million General Fund to create a comprehensive obesity prevention program. The Department of Health Services (DHS) will provide

leadership in preventing obesity by promoting healthy eating, regular physical activity, and responsible choices by individuals. Although the overall objectives will require commitment and action from government, business, academia, and other communities, the budget proposal includes the beginnings of a turning point in the way that Californians approach their eating habits and physical activity.

- **Expanding Health Insurance Coverage for Children**—The Administration proposes a number of incremental reforms that place a priority on maximizing the enrollment and retention of uninsured children eligible for Medi-Cal or Healthy Families. These reforms advance a number of important objectives, including increased awareness about the importance of health coverage and the availability of no and low-cost insurance plans for children of low-income families, simplified enrollment and retention systems, and extended utilization of county-based efforts for children not eligible for State programs.
- **California Rx (Cal Rx)—Prescription Drugs for the Uninsured**—The Administration proposes to make discounted drugs available to California's low-income uninsured families and individuals. The Administration's efforts have brought pharmaceutical manufacturers to the table to develop a framework building upon Medi-Cal's success in negotiating drug rebates.

Department of Health Services

The mission of the DHS is to protect and improve the health of Californians. To accomplish this, the DHS administers a broad range of public health programs and the California Medical Assistance Program (Medi-Cal) for low-income individuals and families. In 2005-06, the DHS' budget totals approximately \$37.6 billion (\$13.7 billion General Fund) and

5,667 positions. Funding for 2005-06 reflects a General Fund increase of approximately \$1 billion compared to the revised 2004-05 Budget due primarily to increases in statutory caseload programs.

Public Health

The DHS administers numerous public health programs to prevent disease and premature death and to enhance the health and well-being of Californians. The DHS works to prevent chronic diseases such as Human Immunodeficiency Virus/Acquired Immune Deficiency Syndrome (HIV/AIDS), cancer, cardiovascular disease, and environmental and occupational diseases. Further, the DHS protects the public from consuming unsafe drinking water, manages and regulates the safety of food, drugs, medical devices, and radiation sources, and operates vital public health laboratories.

State expenditures for all public health programs and State administration total \$3.5 billion (\$703 million General Fund) in 2005-06. This represents an increase of \$53.5 million, or 8.2 percent above General Fund expenditures in the revised 2004-05 Budget.

HIV/AIDS Treatment and Prevention

The Governor's Budget includes approximately \$381 million (\$159.5 million General Fund) for the Office of AIDS' Treatment and Prevention program. This is a total increase of \$20.1 million, or 5.6 percent, above the revised 2004-05 Budget. Nearly 70 percent of total AIDS program expenditures (\$263.6 million) are in the AIDS Drug Assistance Program (ADAP), which provides life-saving medications to low-income persons living with HIV/AIDS. Drugs provided by the ADAP have been shown to prolong quality of life and to delay the deterioration of health among individuals living with HIV. It is estimated that the ADAP will provide treatment to 30,446 clients in 2005-06.

Proposition 99 Expenditures

Smoking rates in California continue to decline, due in part to the effectiveness of the Tobacco Tax and Health Protection Act of 1988 (Proposition 99), the California Children and Families First Initiative (Proposition 10), and California's tobacco control programs. As of December 2004, revenue estimates for fiscal year 2005-06 are approximately \$9 million less than the revised 2004-05 Budget level, continuing the decline in this revenue source.

The Governor's Budget proposes total expenditures of \$315 million for all programs supported by Proposition 99 revenues. The Administration's proposal to maximize available federal funding for prenatal care in the Access for Infants and Mothers Program will generate Proposition 99 savings in 2004-05 and 2005-06 of \$71.4 million and \$80.7 million, respectively. The Governor's Budget also proposes the following additional major changes to Proposition 99 expenditures:

- Provide Proposition 99 support to the Medi-Cal Recent Immigrants Program (\$54.4 million in 2004-05 and \$32.8 million in 2005-06).
- Fund increased hospital service costs within the Department of Mental Health (\$9.8 million in 2004-05 and \$13.6 million in 2005-06).
- Increase funding for the Every Woman Counts Program by \$9 million in 2004-05 and \$12.8 million in 2005-06 to fund increased demand for breast and cervical cancer screening services.
- Augment Proposition 99 funding for the Expanded Access to Primary Care program by \$10 million to maintain program funding at the 2004-05 funding level.

- Restore program funding omitted when the 2003-04 realignment proposal was deferred (\$1.1 million in both 2004-05 and 2005-06).

Children's Medical Services

The Governor's Budget includes \$243.7 million (\$155.7 million General Fund) for the Department's Children's Medical Services programs (CMS), which reflects an increase of \$22.7 million (\$11.6 million General Fund) above the revised 2004-05 Budget. The CMS includes the California Children's Services, the Child Health and Disability Prevention, and the Genetically Handicapped Persons programs, which provide medical services, case management, and medical, physical, and occupational therapy to persons with extraordinary medical needs who are not eligible for Medi-Cal because of their income status.

Bioterrorism Prevention and Preparedness

The Governor's Budget includes \$108.6 million federal funds and 99.5 positions to support California's public health system's capacity to respond to bioterrorism, outbreaks of infectious diseases, and other public health threats.

Funding in 2005-06 will allow the DHS and local public health systems to continue planning and assessment functions and continue developing operational plans for the Strategic National Stockpile (a national repository of pharmaceuticals and medical supplies designed to supplement and re-supply State and local health agencies in the event of a national emergency). The funding also will strengthen hospital, emergency medical system, and poison control center capacity to respond to bioterrorism events.

Newborn Screening Program Expansion

The Governor's Budget includes approximately \$15 million from the Genetic Disease Testing Fund and 2.8 positions to expand the Newborn Screening Program. This expansion will allow the DHS to screen newborns for an additional 37 treatable genetic diseases using Tandem Mass Spectrometry technology. The use of this technology will allow physicians to treat newborns and reduce the debilitating effects of genetic disease.

Medi-Cal

The Governor's Budget proposes \$34.1 billion (\$12.9 billion General Fund) for the Medi-Cal program in 2005-06, a General Fund increase of \$981.7 million, or 8.2 percent above the revised 2004-05 Budget. The General Fund increase primarily reflects increases in caseload and cost per eligible person, increased Medicare premiums, the elimination of 2004-05 one-time savings, changing assumptions of estimated anti-fraud savings, and the implementation of quality improvement fees.

Since 1998-99, Medi-Cal beneficiaries have increased from 5 million eligible persons to 6.8 million eligible persons projected for 2005-06, an increase of 1.8 million beneficiaries.

Program Enhancements and Other Budget Adjustments

- **Maximizing Federal Funding for Prenatal Care—**
The Governor's Budget proposes to take advantage of federal regulations that allow the State to receive federal funding for prenatal care provided in the Medi-Cal and the Access for Infants and Mothers programs. This proposal will result in an additional \$242 million in federal funds and corresponding General Fund savings.

- **Third Party Liability Reform**—The Governor's Budget provides additional staff and funding to increase recoveries from liable third parties for their share of Medi-Cal costs. Potential liable third parties include insurance companies that cover Medi-Cal beneficiaries, workers' compensation cases, Medicare, and estate recoveries. This proposal will provide a net savings of \$19.7 million General Fund in 2005-06.

Managed Risk Medical Insurance Board

Healthy Families Program

The Healthy Families Program (HFP) subsidizes health insurance for children from birth to age 19 in families with low-to-moderate income who are ineligible for no-cost Medi-Cal. The Governor's Budget includes a total of \$894.9 million (\$325.2 million General Fund), an increase of \$33.3 million General Fund above the revised 2004-05 Budget. This increase is primarily the result of enrollment that is projected to grow from 713,900 by year-end 2004-05 to 779,400 in 2005-06 for a total increase of 65,500 children, or 9.2 percent. The Governor's Budget proposes an additional 27.5 positions and \$2.5 million (\$867,000 General Fund) to process application appeals, re-establish the application assistance payments process, and monitor the administration vendor contract as a means to facilitate enrollment and retention of children. This increase advances the Administration's goal that every child in California has health insurance.

Access for Infants and Mothers

This Access for Infants and Mothers (AIM) program provides low-cost, comprehensive health insurance coverage to uninsured pregnant women up to 60 days post-partum and their infants up to two years of age with family incomes

between 200 percent and 300 percent of the Federal Poverty Level (FPL). The Governor's Budget includes a total of \$99.8 million (\$28.5 million General Fund) for this program, a net decrease of \$23.4 million (\$4.3 million General Fund) below the revised 2004-05 Budget. The Governor's Budget also reflects a policy change to take advantage of federal regulations that allow the State to receive federal funding for prenatal care provided in the program.

The decrease in funding for 2005-06 is primarily the result of the enrollment of infants born to AIM mothers directly into the HFP that began in 2004-05. As a result, the number of infants in the AIM program will decrease nearly 88 percent from an average monthly enrollment of 5,930 in 2004-05 to less than 800 in 2005-06. During this period, enrollment of women is projected to increase from 8,500 in 2004-05 to 9,350 in 2005-06, for a total increase of 850 women, or 10 percent.

Department of Developmental Services

The Governor's Budget includes \$3.7 billion (\$2.3 billion General Fund) for the Department of Developmental Services (DDS), a net increase of \$166.4 million (\$129.9 million General Fund) and a decrease of 393 positions from the revised 2004-05 Budget, for programs serving more than 200,000 persons with developmental disabilities.

Developmental Centers

The Governor's Budget proposes \$699.2 million (\$373.1 million General Fund) and 7,912 positions for the developmental centers, a net decrease of \$22.3 million (\$13.9 million General Fund) and 402 positions from the revised 2004-05 Budget. The developmental center population is projected to decline by 236 consumers from 3,307 to 3,071 in 2005-06.

Agnews Developmental Center Closure

The Governor's Budget is adjusted by a net increase of \$36.9 million (\$27.1 million General Fund) for the planned July 2007 closure of the Agnews Developmental Center. The developmental center and the regional center budgets reflect these costs. The goals of the closure plan are to transition residents to safe and stable homes in the community and to ensure ongoing quality of care.

Regional Centers

The Governor's Budget proposes \$3 billion (\$1.9 billion General Fund) to support the regional centers, a net increase of \$187.6 million (\$143.1 million General Fund) from the revised 2004-05 Budget. The regional center community population is projected to increase by 8,765 consumers to 208,020 consumers in 2005-06.

Long-Term Cost Containment

The Administration proposes reasonable, common sense structural reforms for regional center services to contain long-term growth within sustainable limits. Regional centers will use sensible guidelines when developing individual service plans for consumers, purchasing services, and ensuring that consumers have support when developing their own self-directed treatment options. The Governor's Budget includes \$6.2 million General Fund to implement these changes. The resulting General Fund cost reductions to regional center purchase of services are expected to be \$10.5 million in 2005-06, \$20.9 million in 2006-07, and \$31.4 million in 2007-08 and each year thereafter.

Self-Directed Services

In the coming year, the DDS intends to apply for a federal waiver to expand the existing Self-Directed Services

Program to five additional regional centers. The Program will expand statewide in 2006-07. This Program will allow consumers and their families to purchase services and supports through an individual budget “account” based upon the individual’s needs. The Governor’s Budget includes \$1.2 million General Fund to implement the Program. The resulting General Fund savings to regional center purchase of services are estimated to be \$2.2 million in 2005-06, \$14.3 million in 2006-07, and \$29 million in 2007-08.

Department of Mental Health

The Governor’s Budget includes \$2.7 billion (\$1 billion General Fund) and 9,347 positions for mental health services, a net increase of \$171.8 million (\$78.1 million General Fund) and 602 positions above the revised 2004-05 Budget. This net increase primarily reflects population growth in the State hospitals, activation of Coalinga State Hospital, and employee compensation adjustments.

Proposition 63—Mental Health Services Act

Proposition 63, the Mental Health Services Act (MHSA), went into effect on January 1, 2005. The MHSA provides an opportunity to change how mental health care is conceptualized and delivered in California. Consistent with the intent of the MHSA, the Department of Mental Health (DMH) will provide leadership and oversight to ensure that county mental health departments expend funds made available through this initiative to help transform California’s current mental health system. The DMH will present a detailed resource needs assessment for implementation of the MHSA for both 2004-05 and 2005-06 as part of the spring budget process.

State Hospitals

The Governor's Budget includes \$837.5 million (\$670.1 million General Fund) and 9,089 positions for State hospitals in 2005-06, a net increase of \$72.3 million (\$64 million General Fund) from the revised 2004-05 Budget primarily due to a projected net increase of 188 patients, activation of Coalinga State Hospital, and restructures in the supervision and treatment of Sexually Violent Predators (SVPs). The patient population is projected to reach a total of 5,454 patients in 2005-06.

Activation of Coalinga State Hospital

The Governor's Budget includes \$74.2 million (\$65.7 million General Fund) and 709 level-of-care and non-level-of care positions to serve 683 patients in 2005-06 in Coalinga State Hospital (CSH) beginning September 2005. The CSH, a 1,500-bed high-security State mental hospital, will treat all SVP patients currently housed at Atascadero State Hospital and inmates referred from the Department of Corrections. Activation of the remaining 800 beds will continue over the next four fiscal years. Licensure, staffing, and training activities are underway in 2004-05.

Restructure Treatment of SVPs

The Governor's Budget proposes to restructure SVP residential and treatment settings to more efficiently and effectively provide for the varying custody and supervision needs of committed SVPs who are participating in treatment and those who refuse treatment. The Governor's Budget reflects \$6 million General Fund savings due to this proposal. These savings will grow to \$11 million in 2006-07.

Local Custody of Precommitment SVPs

The Administration proposes to keep all precommitted SVPs in local custody until the courts commit them as SVPs. In addition, precommitment SVPs currently residing at Atascadero State Hospital awaiting trial who have not yet been committed as SVPs will be returned to local custody under this proposal. The Governor's Budget includes \$9.2 million General Fund savings due to this proposal.

Community Mental Health Services

The Governor's Budget includes \$1.8 billion (\$304.6 million General Fund), a net increase of \$86.3 million (\$717,000 General Fund) compared to the revised 2004-05 Budget, for community mental health services.

Early and Periodic Screening, Diagnosis, and Treatment Program

The Governor's Budget includes \$801.2 million (\$392.5 million General Fund in the Department of Health Services budget) for the Early and Periodic Screening, Diagnosis, and Treatment Program, an increase of \$76.7 million (\$43 million General Fund) from the revised 2004-05 Budget due to an increased number of projected claims. Under this program, approximately 170,000 Medi-Cal eligible children and young adults receive any service that ameliorates a diagnosed mental illness.

Department of Social Services

The Governor's Budget includes \$16.8 billion (\$8.5 billion General Fund) and 3,944 positions for the Department. This represents a decrease of \$869.9 million (\$307.4 million General Fund) from the revised 2004-05 Budget.

California Work Opportunity and Responsibility to Kids

The Governor's Budget includes total California Work Opportunity and Responsibility to Kids (CalWORKs) expenditures of \$6.7 billion, which includes \$4.9 billion for CalWORKs program expenditures within the Department of Social Services budget, \$1.5 billion in other programs, and \$196.4 million for a CalWORKs program reserve. Other programs include the Statewide Automated Welfare System, Child Welfare Services, California Food Assistance Program, State Supplementary Payment, Foster Care, State Department of Education child care, California Community Colleges child care and education services, Department of Child Support Services disregard payments, Department of Developmental Services programs, and county expenditures. Caseload growth is continuing to flatten after many consecutive years of decline. The revised caseload projections are 495,000 cases in 2004-05 and 473,000 cases in 2005-06.

The Governor's Budget proposes reforms that reduce program costs and improve county performance while continuing to place a greater emphasis on work participation and personal responsibility. Key revisions to the CalWORKs program budget include the following:

- **Align CalWORKs Benefits with Other**

States—CalWORKs program benefits are among the most generous of the ten most populous states. Program reforms that align benefit levels with Temporary Assistance for Needy Families programs in other states are necessary to ensure the long term viability of the program.

- **Reduce CalWORKs Grants**—CalWORKs grant levels are currently highest among the ten most populous states. This proposal will reduce grants by

6.5 percent for savings of \$212.3 million. Even with this reduction, California's grant levels will be the fourth highest of all 50 states and second highest of the 10 most populous states.

- **Eliminate the Statutory Requirement to Provide a Cost-of-Living Adjustment (COLA)**—CalWORKs grant COLAs are statutorily required each year without consideration of whether sufficient resources are available to support them. Eliminating the COLA will result in savings of \$163.8 million in 2005-06 and will allow the Administration and the Legislature to annually evaluate how best to invest available resources to help recipients move into the workforce.
- **Reduce the Income Disregard**—California has one of the most generous income disregard policies in the nation. This proposal will allow CalWORKs families to keep \$200 and 40 percent of remaining earned income rather than the current \$225 and 50 percent of remaining earned income. This change will result in savings of \$79.5 million in 2005-06 and \$109.3 million annually thereafter. This proposal will more closely align California's policies with other large states while continuing to maintain a significant incentive for individuals to work and earn income.
- **Pay for Performance**—The Governor's Budget includes a new incentive system that bases a portion of the counties' single allocation for administration and employment services on specific outcomes of CalWORKs clients in each county. The Pay for Performance model will help to ensure that counties invest resources in activities that are most effective and efficient in achieving the desired outcomes. This proposal is estimated to result in savings of \$22.2 million in 2005-06 through lower grant costs as participants

increase both the number of hours worked and their earnings.

- **Strengthen Work Requirements**—Reforms included in the 2004 Budget Act to strengthen the work focus of the CalWORKs program will be enhanced in 2005-06. These reforms will promote earlier employment, reduce reliance on public assistance, and support California's ability to meet increased federal work participation requirements. The Administration proposes to build on these reforms after completing an evaluation of current CalWORKs sanction policies. Savings resulting from providing further incentives to work are targeted at \$12 million in 2005-06.

Supplemental Security Income/State Supplementary Payment Program

Total General Fund expenditures for the Supplemental Security Income/State Supplementary Payment (SSI/SSP) program are projected to be over \$3.5 billion in 2005-06. This represents a 1.1 percent increase from the 2004 Budget Act. The caseload in this program is estimated to be 1.2 million recipients in 2005-06, a 2.3 percent increase over the 2004-05 projected level.

Given the State's severe fiscal constraints, the Administration proposes that the January 2006 State COLA of 4.6 percent be suspended, and the pass-through of the January 2006 federal COLA of 2.3 percent be withheld for General Fund savings of \$258.9 million in 2005-06 and \$517.8 million annually thereafter. These proposals will not change the amount of the monthly grants for SSI/SSP recipients, which will be \$812 for an aged or disabled individual and \$1,437 for a couple, effective April 2005. Even with these actions, California continues to provide the highest level of cash grants to SSI/SSP recipients among the ten most populous states.

In-Home Supportive Services

General Fund expenditures in the In-Home Supportive Services (IHSS) program are projected to be \$1 billion in 2005-06. This represents an 11.6 percent decrease from the 2004 Budget Act. Given the State's severe fiscal constraints and significant relief afforded counties by the recent IHSS waiver, the Administration proposes to limit State participation in IHSS worker wages and health benefits to the State minimum wage of \$6.75 per hour. Counties have the option of reinvesting local savings of \$112 million from 2004-05 and \$93 million from 2005-06 obtained by the Administration under the waiver. This redirection will avoid more severe reductions in services.

Child Welfare Services

California provides a comprehensive system of services and out-of-home care for children who are either at risk of or have suffered abuse and neglect. The Child Welfare Services (CWS) program includes services to protect children and reunite families when possible, or to find alternate permanent families for children when they cannot return home safely. The Governor's Budget includes \$2 billion (\$645.1 million General Fund) for these services.

CWS Program Improvement Plan—In 2002, California failed a total of 12 out of 14 outcome measures in a federal review of California's CWS program and is currently operating under a federally required Program Improvement Plan (PIP) to improve program performance. In 2004-05, 11 counties are implementing systemic program changes which are included in the State's PIP. The Governor's Budget includes \$14.1 million General Fund for 11 additional counties to implement these activities, which will result in improved performance and reduce the potential for federal penalties for PIP noncompliance.

Department of Child Support Services

The Governor's Budget includes \$1.4 billion (\$508.2 million General Fund) and 329 positions for the Department. This funding level represents an increase of \$279.2 million (\$205.5 million General Fund) from the revised 2004-05 Budget. This increase is due primarily to the \$218 million payment of the alternative federal penalty for the California Child Support Automation System (CCSAS).

Child Support Automation

Chapter 479, Statutes of 1999, designated the Franchise Tax Board as the agent of the Department of Child Support Services for the procurement, development, implementation, and maintenance and operation of a new statewide automated child support system, the CCSAS. The State is responsible for developing and implementing the CCSAS and transitioning all counties onto this new system. The CCSAS is expected to be finalized and fully functional on a statewide basis as required by the federal government in September 2008. The Governor's Budget includes \$218 million General Fund to pay the 2005 Alternative Federal Penalty due in September 2005. This proposal will allow the State to continue operating the Child Support Program in 2005-06 without loss of the program's federal share of funding, which is estimated to be \$866.3 million in 2005-06, or jeopardizing the Temporary Assistance for Needy Families program in the Department of Social Services, which is estimated to be \$3.7 billion in 2005-06.

Health and Human Services Savings Proposals

Notwithstanding the value and importance of the services provided by departments under the purview of the HHSA, many of the Agency's major programs are significant con-

tributors to the overall growth in State expenditures. The State's fiscal challenges compel the Administration to bring overdue focus and attention to the need to reduce expenditures so as not to exceed available General Fund resources. The Governor's Budget proposes reforms, reductions, and savings for a number of HHS programs, including Medi-Cal and CalWORKs. Those reductions are highlighted below, and are also addressed further as part of individual departmental highlights.

Department of Health Services

- **Additional Medi-Cal Pharmacy Rebates**—\$20 million General Fund savings in recently negotiated rebates for heartburn medication.
- **Maximize Federal Funds for Prenatal Care**—\$191 million General Fund savings reflecting accessing federal funding for prenatal care provided in Medi-Cal.
- **Medi-Cal Redesign**—\$12.3 million General Fund savings attributed to redesigning Medi-Cal to increase efficiency and effectiveness for beneficiaries and providers, improve health care outcomes, and to aid in the long-term financial viability of the program.
- **AIDS Drug Assistance Program Rebates**—\$8.8 million General Fund savings related to higher-than-anticipated collections of drug manufacturer rebates.
- **Eliminate General Fund Support for the Office of Binational Border Health**—\$694,000 General Fund savings for this office, which coordinates local border health agencies. This reduction is compelled by the need to save funds in the Budget and will have a minimal impact on communication between California and Mexican officials regarding disease prevention;

\$500,000 in federal funds still remain to support the office's mission.

Department of Mental Health

- **Return Custody of Precommitment Sexually Violent Predators to Local Custody**—\$9.2 million General Fund savings for the State hospitals in 2005-06, by keeping precommitment SVPs in local custody until they are committed by the courts as SVPs, and by transferring existing precommitment SVPs in State hospitals to local custody.
- **SVP Treatment Restructuring**—\$6 million General Fund savings for the State hospitals in 2005-06, growing to \$11 million in 2006-07, by restructuring supervision and treatment services provided by State hospitals to SVPs.

Managed Risk Medical Insurance Board

- **Maximize Federal Funds for Prenatal Care**—\$51 million General Fund savings reflecting accessing federal funds for prenatal care provided in the Access for Infants and Mothers program.

Department of Community Services and Development

- **Eliminate Naturalization Services Program**—This program assists immigrants in obtaining citizenship. Elimination of this program will result in General Fund savings of \$1.5 million in 2005-06 and annually thereafter. Similar services are provided by State Department of Education programs.

Department of Social Services

- **Eliminate CalWORKs Cost-of-Living Adjustment—** This proposal will eliminate the statutory requirement to provide an automatic annual grant COLA, which is required regardless of whether sufficient resources are available to support such an increase. This will result in savings of \$163.8 million in 2005-06 and annually thereafter.
- **Strengthen Work Requirements—** This proposal will build on reforms included in the revised 2004-05 Budget to strengthen the work focus of the CalWORKs program. The Department of Social Services will reexamine individual work requirements in the spring after it has completed the statutorily required evaluation of CalWORKs sanction policies in order to determine additional changes to increase participation in work. Savings are targeted at \$12 million beyond the 2005-06 impact of the CalWORKs reform enacted in 2004-05.
- **Reduce the Earned Income Disregard—** This proposal will allow CalWORKs families to keep \$200 and 40 percent of remaining earned income rather than the current \$225 and 50 percent of remaining earned income. This proposal will result in savings of \$79.5 million in 2005-06 and \$109.3 million annually thereafter. California's earned income disregard policy will continue to be one of the most generous among the large states and will continue to offer a significant incentive to work.
- **CalWORKs Pay for Performance Proposal—** The Administration proposes to implement a new incentive system that bases a portion of the counties' single allocation for administration and employment services on specific outcomes of CalWORKs clients in each county. The Pay for Performance model will help to

ensure that counties invest resources in activities that are most effective and efficient in achieving the desired outcomes, such as higher work participation rates among CalWORKs recipients. This proposal is estimated to result in savings of \$22.2 million in 2005-06.

- **CalWORKs Grant Reduction**— This proposal will reduce grants by 6.5 percent to align benefit levels better with Temporary Assistance for Needy Families (TANF) programs in other states to obtain General Fund savings. Even with this reduction, California's grant levels will remain the fourth highest of all 50 states and the second highest of the 10 most populous states. This proposal will result in savings of \$212.3 million in 2005-06 and annually thereafter.
- **Eliminate Employment Services Augmentation**— This proposal will delete the one-time legislative augmentation for CalWORKs employment services provided in 2004-05 for savings of \$50 million. The CalWORKs budget maintains an augmentation of \$191.9 million for employment services provided in 2004-05 and 2005-06 to enable counties to provide services tailored to their individual needs to move CalWORKs recipients from public aid to employment.
- **Reduce Current Year Tribal TANF Expenditures**— This proposal will reduce the amount of State funding provided to the tribal entities in 2004-05 to reflect an anticipated decline in programmatic expenditures. This one-time adjustment will result in savings of \$5 million.
- **Offset Changes in 2004-05 Expenditures with Savings**— This proposal will modify the past practice of not adjusting current year funding when updated current year estimates result in lower costs. While counties historically received increases for current year caseload growth, employment services and

administration components were not adjusted when current year estimates resulted in lower costs. Making all adjustments will result in a savings of \$42.9 million.

- **Suspend State Participation in Increased Contract Costs for In-Home Supportive Services**—Consistent with collective bargaining mandates, 12 counties negotiated contracts to increase IHSS service provider wages and/or health benefits since the 2004 Budget Act. Current law requires the State to pay a share of cost, and does not afford consideration of the State's ability to pay. This proposal will maintain State participation in wages and health benefits at the level of funding in the 2004 Budget Act and will result in General Fund savings of \$42.7 million annually.
- **Reduce State Participation in IHSS Wages/Health Benefits**—The Administration proposes to reduce the maximum level of IHSS provider wages and benefits in which the State will participate to the minimum wage (\$6.75 per hour). Currently, the State shares up to \$10.10 per hour in provider wages and benefits, and up to the Maximum Allowable Contract Rates for contract providers. This proposal will result in General Fund savings of \$152.1 million in 2005-06 and \$216.8 million annually thereafter. Counties have the option of reinvesting local savings of \$112 million from 2004-05 and \$93 million from 2005-06 obtained by the Administration under the waiver. This redirection will avoid more severe reductions in services.
- **Suspend Supplemental Security Income/State Supplementary Payment (SSI/SSP) COLA**—The Administration proposes that the January 2006 State COLA be suspended, for General Fund savings of \$174.2 million in 2005-06 and \$348.4 million annually thereafter. This proposal will not change the amount of the monthly grants received by SSI/SSP participants.

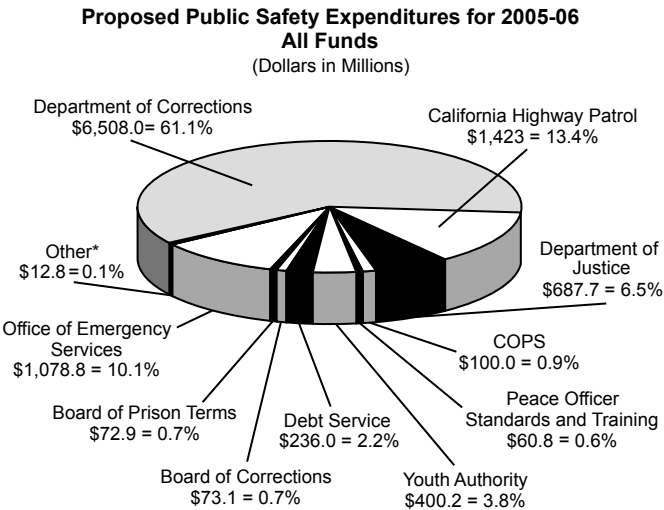
- **Capture General Fund Savings Equal to the Federal SSI COLA**—The Administration proposes that the pass-through of the January 2006 federal COLA be withheld for General Fund savings of \$84.7 million in 2005-06 and \$169.4 million annually thereafter. This proposal will not change the amount of the monthly grants received by SSI/SSP participants.

Department of Developmental Services Savings Proposals

- **Proposals for Long Term Cost Containment**—\$4.2 million net General Fund savings in the regional centers budget in 2005-06, growing to \$14.7 million in 2006-07 and \$25.2 million in 2007-08, for regional center use of sensible guidelines when developing consumer service plans and purchasing services.
- **Expansion of Existing Self-Directed Services**—\$1.3 million net General Fund savings in the regional centers budget in 2005-06 for regional center expansion of an innovative self-directed services program. These savings are partially offset by \$282,000 in implementation costs of the Department of Developmental Services (DDS) headquarters.
- **Redirect Federal Funds to DDS Programs**—This proposal will transfer \$60 million in available Title XX federal funds from the Department of Social Services budget to offset a like amount of General Fund costs in the DDS budget. This will result in General Fund savings of \$60 million in 2005-06 and annually thereafter.

Public Safety

Figure PUB-01



* Includes the Youth and Adult Correctional Agency, the Commission on Correctional Peace Officers' Standards and Training, and the Office of the Inspector General.

The 2005-06 Governor's Budget proposes total funding of approximately \$10.7 billion for various programs within the Youth and Adult Correctional Agency, Department of Justice, Office of Emergency Services, Commis-

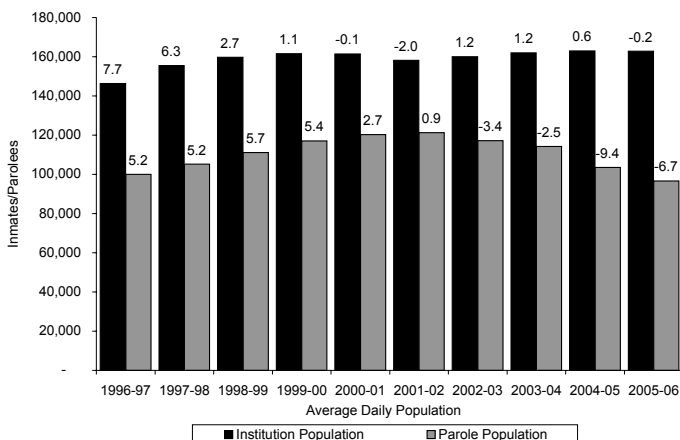
sion on Peace Officer Standards and Training, and the California Highway Patrol. The amount proposed is a 0.1 percent increase over the revised 2004-05 Budget. The more significant funding changes for these programs are:

Department of Corrections

Population—Prison inmate average daily population is projected to decrease from 163,019 in 2004-05 to 162,755 in 2005-06, a decrease of 264 inmates, or 0.2 percent. The difference is due to the increasing impact of the parole reforms included in the 2003 and 2004 Budget Acts. However, the current projections are higher than the 2004 Budget Act projected average daily inmate population due to increased new admissions from court and parole violators returned with new terms, as well as delays in implementation of the parole reforms from the 2003 and 2004 Budget Acts. The average daily parole population is projected to decrease from 103,492 in 2004-05, to 96,602 in 2005-06, a decrease of 6,890 parolees, or 6.7 percent. The parole population is projected to be lower due to ongoing implementation of parole policies and practices designed to ensure public safety and be consistent with current law.

Figure PUB-02

Institution and Parole Population Percentage Change



The costs associated with the population changes are \$207.5 million General Fund in 2004-05 and \$280.2 million General Fund in 2005-06. In 2005-06, incarceration services will be provided through 33 institutions, 11 reception centers, 40 camps, and 12 community correctional facilities.

Inmate Medical Services Program

Implementation—The Administration is committed to providing quality inmate medical services and continued compliance with the requirements of the Plata class action lawsuit. As such, the Budget includes an increase of \$30.1 million General Fund, which is designed to improve the delivery of medical care to inmates and to ensure compliance with the court order.

Post Relief—The Administration has demonstrated its support of the Department of Corrections' base mission through various budget augmentations related to structural operating costs. This Budget continues this effort by providing funding of \$9.8 million General Fund to enable the Department to provide the necessary training for posted positions and medical technical assistants and adjust sick time costs to reflect anticipated usage rates.

Incarceration of Undocumented Felons

The State of California expects to spend approximately \$729.7 million in 2005-06 for the incarceration of undocumented persons in the Departments of Corrections and Youth Authority. The Budget anticipates that the State will receive approximately \$78.5 million in 2005-06 from the federal government under the State Criminal Alien Assistance Program for partial reimbursement of these costs.

Board of Corrections

Juvenile Justice Funding—The Governor's Budget includes the restoration of \$201.4 million in federal Temporary Assistance for Needy Families funding for county youth probation programs, these funds are provided as part of the Department of Social Services budget. In addition, the Board of Corrections will be responsible for administering \$25 million General Fund (\$24.7 million local assistance, \$250,000 state operations) previously provided through the Juvenile Justice Crime Prevention Program, providing a total of \$226.4 million in State funding for local juvenile justice activities. The remaining funding associated with the Juvenile Justice Crime Prevention Program will be eliminated, resulting in a General Fund savings of \$75 million. The final distribution of this savings will be determined by the outcome of negotiations related to juvenile justice reforms proposed by the Administration, and could result in changes in funding for the Board of Corrections and the Youth Authority.

Board of Prison Terms

Valdivia Remedial Plan—In recognition of the need to enhance the provision of due process to parolees held on suspicion of parole violation, \$2.5 million General Fund is included in fiscal year 2004-05 and \$6.9 million General Fund is included for fiscal year 2005-06 to provide sufficient staffing and resources to address a higher number of parole revocation hearings than anticipated in the 2004 Budget Act. The Budget also includes a current year increase of \$6.5 million General Fund for attorney fees the State has been ordered to pay for the Valdivia class action lawsuit.

Department of the Youth Authority

Institution and Parole Population—The Youth Authority projects an institution population of 3,330 on June 30, 2006, which is a decrease of 100 wards from the anticipated population of 3,430 on June 30, 2005. The parole caseload is projected to be 3,450 by June 30, 2006, which is a decrease of 340 cases from an estimated caseload of 3,790 on June 30, 2005. The net effect of these population changes in fiscal year 2004-05 is a decrease of \$1.6 million (a decrease in Reimbursements of \$9.9 million, a decrease in General Fund [Proposition 98] of \$0.3 million, and an increase in General Fund [Non-Proposition 98] of \$8.6 million). In fiscal year 2005-06, the net effect will be a decrease of \$11.5 million (a decrease in Reimbursements of \$11.7 million, a decrease in General Fund [Proposition 98] of \$1.4 million, and an increase in General Fund [Non-Proposition 98] of \$1.6 million). As part of the Juvenile Justice Reform proposal, the Administration is evaluating options to shift some of this population to locals.

Conditions of Confinement and Treatment—The Administration continues its efforts to address issues related to the conditions of confinement and treatment of wards at the Youth Authority, resulting from the *Farrell v. Allen* lawsuit. The final Remedial Plan and implementation schedule are currently in the negotiation and approval process. Details of this plan and associated funding needs will be provided as part of the May Revision.

Office of the Inspector General

Development of Workload Budget—Governor Schwarzenegger signed Chapter 733, Statutes of 2004 (SB 1342), which established specific requirements and protocols for the Office of the Inspector General (OIG) to follow when conducting investigations. In order to implement this legislation and ensure that the OIG has the appropriate level of

resources, the OIG, in consultation with the Department of Finance, is in the process of developing a methodology for producing a workload budget consistent with the legislative requirements. Details of this methodology and associated funding needs will be provided as part of the May Revision.

Department of Justice

The Budget includes total expenditures of \$687.7 million for the Department of Justice and proposes the following augmentations for fiscal year 2005-06:

DNA Fingerprint, Unsolved Crime and Innocence Protection Act (Proposition 69)—With the passage of Proposition 69, DNA information for every felon, including those currently incarcerated or on probation or parole, will be contained in the State's DNA Data Bank, which will greatly enhance law enforcement's ability to solve crimes. To begin implementation, the Budget includes a current year augmentation of \$11 million from the DNA Identification Fund, which includes a \$7 million General Fund loan to the DNA Identification Fund as authorized in the Proposition, and includes \$11.2 million from the DNA Identification Fund in 2005-06 for the Department of Justice to address workload resulting from expanded collections of DNA, palm prints, and thumbprints. In addition, the Budget includes \$4 million in fiscal year 2004-05 and \$3.6 million in fiscal year 2005-06 for the Department of Corrections to obtain the necessary samples from inmates and parolees.

Criminal Justice Information System Redesign—The Budget proposes an augmentation of \$4 million General Fund to redesign the Wanted Persons, Stolen Vehicles, Supervised Release File, Firearms Eligibility Applicants, and Domestic Violence Restraining Order automated database systems. These current systems are at risk of failure, and with the migration to an open systems environment, the

ability to exchange data and interface with State, local, and federal agencies will be greatly improved.

Violent Crime Information Network (VCIN) Renovation—Repeated system modifications have jeopardized the functionality of the VCIN, which is the State's central database of registered sex offenders. In order to ensure complete and accurate data to effectively store, access, and disseminate information regarding the location of sex offenders, the Budget proposes \$1.8 million General Fund for ongoing technical support and modifications to the VCIN.

Office of Emergency Services

Local Assistance Reductions to Public Safety Programs—The Administration proposes to reduce public safety local assistance programs by \$4 million General Fund. This represents an overall reduction of 3.8 percent for these programs and a General Fund reduction of 10.3 percent. This reduction will be accomplished by eliminating the Community Crime Resistance Program (a reduction of \$231,000), Career Criminal Apprehension Program (a reduction of \$866,000), Serious Habitual Offender Program (a reduction of \$137,000), Vertical Defense of Indigents Program (a reduction of \$172,000), and Drug Abuse Suppression in Schools Program (a reduction of \$690,000). In addition, the Rural Crime Prevention Program will be reduced by \$1.9 million, a 57 percent reduction over the current funding level.

Office of Homeland Security Grant Administration—The Administration continues to demonstrate its support for homeland security efforts by providing an increase of \$1.8 million (\$1.7 million federal funds and \$0.1 million Anti-terrorism Fund) for grant administration to ensure that State and local governments, tribal agencies, and certain private

non-profit organizations, are able to receive all eligible federal and State homeland security grants in a timely manner.

Disaster Service Worker Volunteer Program—In recognition of the importance of providing benefits for the loss of wages and medical coverage to Disaster Service Worker volunteers injured while participating in approved disaster-related activities, the Budget proposes an increase of \$462,000 General Fund for the Disaster Service Worker Volunteer Program.

CALGANG Project—Of the funding available for Gang Violence Suppression grants, the Administration proposes to provide \$300,000 to the CALGANG Project. This dedicated funding source will allow the CALGANG Project to ensure that the centralized coordination of California's gang intelligence information is maintained and readily accessible to aid law enforcement in their mission to combat the increase of violence resulting from California's gangs.

Resources and Environmental Protection

Resources

- **All-American Canal**—The Budget provides \$59.1 million General Fund for the lining of the All-American and Coachella canals. This funding is consistent with the Quantification Settlement Agreement (QSA), which is a comprehensive agreement among the federal government, State, and various local water agencies to reduce California's use of Colorado River water. These canal lining projects are estimated to save approximately 100,000 acre feet of Colorado River water.
- **River Parkways Program**—The Budget includes \$38.4 million (\$30.5 million Proposition 50 and \$7.9 million Proposition 40 bond funds) to provide grants for the development and protection of river parkways, including park development, habitat restoration, and the development of public access trails along state rivers.
- **Blue Ribbon Fire Commission Recommendations**—In 2003, wildfires in Southern California burned 750,043 acres, destroyed 3,710 homes, and resulted in 24 lives lost, including one firefighter. The Blue Ribbon Fire Commission was established to review the efforts to fight the 2003 wildfires and provide recommendations to

prevent destruction from future fires. Consistent with the Commission's recommendations, the Budget provides a total of \$22.7 million General Fund for fire engine and helicopter replacement (\$10.8 million), year-round staffing in Southern California (\$9 million and 48.8 positions), and conversion and replacement of radio equipment (\$2.9 million).

- **Southern California Fuel Management**— The Budget also includes \$3.8 million in federal funds and 19 positions to address the severe fire conditions in Southern California. Five years of severe drought have left Southern California forests vulnerable to bark beetle infestation, which has resulted in a significant number of dead and dying trees and has created extreme fire conditions. The U.S. Forest Service has provided grant funding for various forest health enhancement projects, including the removal of dead trees and forest restoration.
- **Americans with Disabilities Act (ADA) Transition Plan: Year 4**— The Budget provides \$11.8 million General Fund and Off-Highway Vehicle Trust Fund to continue efforts to improve ADA accessibility at State parks and facilities.
- **Sierra Nevada Cascade Mountains Protection**— The Budget includes \$11.7 million from Proposition 50 to provide grants for the acquisition of land and water resources to protect lakes, reservoirs, rivers, streams, and wetlands in the Sierra Nevada region. The Secretary for Resources also will coordinate with the newly created Sierra Nevada Conservancy to ensure the environmental preservation of the Sierra Nevada Mountains.
- **Flood Control Strategic Improvements**— Under *Paterno v. State of California*, the State was found to be liable for damages from the 1986 floods. To further protect property and prevent future floods, the

Resources and Environmental Protection

Budget provides \$9.7 million General Fund for levee maintenance activities, engineering evaluations of the structural integrity and capacity of levees, improved emergency response capabilities, and floodplain mapping activities to identify areas vulnerable to floods.

- **Hearst Ranch**—The Budget proposes \$1.3 million General Fund to operate the Hearst Ranch conservation acquisition. Two million individuals are expected to visit the property annually. The funding will provide for public access planning and maintenance; coastal trail design, development, and management; and natural resource management and monitoring.
- **California Ocean Protection Act**—The Budget proposes \$1.2 million Environmental License Plate Fund to establish the Ocean Protection Council. Pursuant to Chapter 719, Statutes of 2004, the Council will coordinate the state's coastal waters and ocean ecosystem protection and conservation efforts. The Council also will develop strategies to ensure the sustainability of ocean resources and habitats.

California Environmental Protection Agency

- **Exposure to Fine and Ultrafine Particulate Matter**—The Budget includes \$8.6 million (\$3 million Motor Vehicle Account and \$5.6 million Air Pollution Control Fund) and 20 positions to meet workload growth in monitoring, assessing, and mitigating fine and ultrafine particulate matter (Particulate Matter 2.5). The U.S. Environmental Protection Agency has directed states to develop, by January 2008, a State Implementation Plan describing how they will come into compliance with new 24-hour and annual standards for Particulate Matter 2.5. California has the most serious Particulate Matter 2.5 pollution of any state because

of its unique combination of vehicle use, agricultural operations, meteorology, and geography.

- **Carl Moyer Program**—The Budget includes 11.4 positions and \$1.2 million Air Pollution Control Fund to implement the provisions of Chapter 707, Statutes of 2004. This bill expands the Carl Moyer Program to reduce pollutants such as particulate matter and reactive organic gases. The bill also expands the current program to include light and medium-duty vehicle projects, such as scrappage and parts replacement, and expands the eligibility for grant funding to previously unregulated sources, such as agricultural pollutant sources. The Budget also includes \$23.8 million in Air Pollution Control Fund for local air districts to use for mobile source emissions mitigation.

Energy

The California energy crisis of 2000-01 had a severe economic impact on the state. Four years after the crisis, state government is still addressing some of the fundamental flaws in the energy market. The Administration is committed to fixing the electricity market and establishing a regulatory environment that attracts investment in new power plants and transmission lines. Actions by the Administration to avert another energy crisis include the following:

- **Promote Long-Term Energy Contracts—** Part of the energy crisis was caused by over-reliance on short-term power purchases, which proved to be highly volatile and extremely costly. Encouraging utilities to enter into long-term contracts stabilizes energy supplies, reduces long-term prices, and leads to the construction of new power plants. The Public Utilities Commission (PUC) has adopted rules that will result in utilities entering into competitive, cost-effective long-term contracts with energy providers by this summer. This will ensure that Californians will get the best possible deal in terms of price, risk, reliability, and environmental impact.
- **Adequate Planning Reserves—** The PUC adopted the Administration's recommendation to require 15 percent electricity reserve margins by 2006. Utilities are now

in the process of signing contracts and securing those supplies. In addition, new rules are being developed to ensure that the power can be delivered when and where it is needed most.

- **Competitive Procurement**—The Administration supports establishing a competitive and transparent procurement process that gives utilities the ability to purchase power at the lowest possible price. Competitive purchasing will attract new energy investment into the state and shift the risk of power plant construction and operation from ratepayers to power suppliers.
- **Renewable Energy**—The Administration supports an acceleration of the Renewable Portfolio Standard mandate of 20 percent renewable by 2010, rather than 2017, and 33 percent by 2020. The Administration has engaged with the Western Governor's Association on a Clean Energy Resolution to identify strategies that would produce 30,000 megawatts (MW) of clean energy in the West by 2015. Recognizing the benefits of renewable power generation across the West, the Administration supports a renewable energy trading regime that promotes renewable power development throughout the region. The PUC has adopted this policy by requiring power companies to meet the accelerated date in their procurement plans currently being submitted for approval.
- **Million Solar Roofs Initiative**—The Administration will continue to pursue its initiative to increase the use of solar energy across the state. The goal of the initiative is to promote the development of one million solar roofs (up to 3,000 MW) on residential and commercial buildings. Solar power will help California reduce its peak electricity demand, reduce congestion on an overly burdened transmission and distribution system, produce clean energy, and reduce the state's dependence on fossil fuels.

- **Green Buildings**—On December 14, 2004, the Governor signed an executive order that calls on the State to increase the energy efficiency in its buildings 20 percent by 2015. The order also is part of a Green Building initiative that encourages the private sector to set the same goals for commercial buildings. Taxpayers can expect to save up to \$100 million per year in reduced energy and resource costs.
- **Expand Transmission Infrastructure**—The Administration is seeking all opportunities to enhance and expand the transmission grid as a way to reduce congestion costs, improve reliability, and provide a path to accessing cleaner, more cost-effective energy sources.

A list of additional actions initiated by the Administration to solve the energy problem can be found in the Governor's Budget Summary.

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Business, Transportation, and Housing

The Governor's Budget proposes total expenditures of \$11.6 billion in 2005-06 for roads, highways, mass transit and intercity rail, vehicle licensing and registration, highway law enforcement, housing, and regulation of businesses.

Housing Affordability

In pursuit of the common-sense concept that each local government should "take care of their own," the Administration will seek to reform onerous regulatory and planning laws to promote home building and accountability for housing production while requiring less paperwork between local governments and the State. Every local jurisdiction should plan for and be prepared to accommodate their own natural population increase and workforce, and to do so on the most efficient land use pattern possible, minimizing impacts on valuable habitat and productive farmland.

Transportation Resources

Total State and local transportation resources are estimated to be approximately \$18.9 billion in 2005-06, a slight increase from \$18.8 billion in the current year. Although the main State revenue sources such as fuel excise tax and

truck weight fees continue to grow, overall transportation revenues have been relatively stable.

Proposition 42—Beginning in 2007-08, the Administration is committed to restoring the dedication of Proposition 42 funds to transportation as the voters intended. As part of the Administration's budget control proposals, the suspension of Proposition 42 transfers would be Constitutionally prohibited after 2006-07. Proposition 42 transfers that are suspended will be treated as loans and will be repaid within a 15-year period, in even increments, unless early repayment is made. The structural budget problem has forced the Administration to propose a suspension of the Proposition 42 transfer of \$1.31 billion for the 2005-06 fiscal year. This suspension will be considered a loan with the same repayment structure.

GoCalifornia—The continuing budget crisis forces fiscal actions in the short term that limit the availability of traditional transportation resources. However, the Administration proposes a comprehensive initiative, "GoCalifornia," to enhance the impact of transportation investments now and in the future. As part of this effort, new performance measures for both the transportation system and State management have been developed in partnership with statewide transportation stakeholders and are being implemented. The Administration will propose a comprehensive package of management and project delivery proposals for the 2005-06 legislative session.

Public Transportation Account "Spillover" Revenues—The Budget proposes to suspend transfer of sales tax monies to the Public Transportation Account in 2005-06. These revenues are estimated to be \$216 million. Other sales tax revenues deposited in the Public Transportation Account are \$275 million in 2005-06, a modest increase of \$9 million over the current year.

Department of Transportation

California transportation supports the mobility of goods and people, creates jobs directly and throughout the economy, and leverages local and federal resources for critical mobility and air quality projects through its borders, ports, rail, and highway corridors. The Budget includes \$8 billion in expenditures by the Department of Transportation (Caltrans) and 22,445.5 positions.

Major Maintenance and Culvert Inspection Program—

The Budget includes \$45.8 million and 40 positions for a \$42.3 million increase in major maintenance contracts and to establish a new culvert inspection program that will establish a statewide inventory of all drainage facilities including location, geographic information system data, design information, and structural deficiencies.

Stormwater Best Management Practices—In response to a court mandate to employ structural storm water treatment Best Management Practices, as well as to comply with Total Maximum Daily Loads regulations set by local and regional water quality control boards, the Budget includes \$11.7 million and 43.2 positions.

High Speed Rail Authority

Environmental Impact Report Workload and Financial Plan Preparation—The Budget includes a one-time augmentation of \$2.7 million for legal defense of the Environmental Impact Report (EIR); additional environmental work on the San Jose-to-Merced route alignment; and completion of a business plan.

Department of Housing and Community Development

General Fund Reduction—The Department has been instructed to reduce its state operations budget by \$76,000 with the flexibility to implement through layoffs, hiring freeze, procurement reductions, or other administrative means as it may choose. In the Department of Housing and Community Development, the General Fund supports the following state operations: State Housing Law and Employee Housing Law enforcement; administration of the California Indian Assistance, Community Development Block Grant, Emergency Shelter, Housing Assistance, and Migrant Services programs; Housing Element, and Redevelopment Agency oversight, reporting, and audits.

Emergency Shelters—The Budget reduces the Emergency Housing Assistance Program by \$864,000, to \$3.1 million. This program provides State grants (averaging about 10 percent of costs) for local agency-operated homeless shelters.

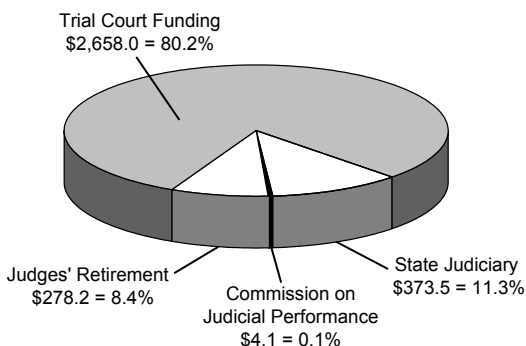
Office of Migrant Services (OMS) Reconstruction Plan—\$9.5 million is included in the 2005-06 Budget from Proposition 46 (housing bond) funds to continue the OMS reconstruction plan to address health and safety standards deficiencies at the State-built OMS centers, which provide housing for farmworkers throughout California. Operating funds for this program are not reduced.

Judicial Branch

The 2005-06 Governor's Budget includes a total of \$3.4 billion (\$1.9 billion General Fund) for the Judicial Branch. (See Figure JUD-01, "Total Judicial Branch Expenditures for 2005-06.")

Figure JUD-01

Total Judicial Branch Expenditures for 2005-06
All Funds
(Dollars in Millions)



For the Judiciary and Trial Court Funding, the 2005-06 Governor's Budget reflects total expenditures of \$3 billion. Specifically, the Judicial Branch's budget includes the following adjustments:

Trial Court Administrative Services Support—The Budget includes an increase of \$4 million reimbursements and 50 positions in 2004-05 and \$13.1 million reimbursements and 109 positions in 2005-06 for the Administrative Office of the Courts (AOC) to provide administrative services support (such as accounting, human resources, and treasury) solely to the Trial Courts. This is a redirection of resources, as this is not a new activity but merely a shift in responsibilities from local courts to the AOC. With this proposal, administrative services for approximately one-third of the trial courts will have been assumed by the AOC, with the remaining courts transitioning by 2008-09.

Increased Trial Court Costs—Due to concerns that increased costs would erode Trial Court services, budget trailer bill language accompanying the 2004 Budget Act required an annual budget increase for operational costs equal to the increase in the State Appropriations Limit (SAL). Prior to the application of the growth factor, various baseline cost issues needed to be addressed to provide a fair and reasonable baseline budget for the Trial Courts. As a result, an increase of \$88.4 million has been included for fiscal year 2004-05, along with an ongoing baseline adjustment of \$92.6 million beginning in 2005-06. These costs are related to court employee salary and benefits, court employee retirement, court security, and county-provided services.

Growth Factor Increase—Consistent with the statutory requirement, an increase of \$97.4 million has been included for Trial Court Funding in the Governor's Budget. This is the first year the trial court program has been increased by the growth factor as opposed to submission of individual Budget Change Proposals. This new methodology grants budgetary independence, as is appropriate for a separate branch of government.

Judicial Branch

For the Commission on Judicial Performance, the 2005-06 Governor's Budget reflects total expenditures of \$4.1 million, which reflects continuation of the current level of funding.

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General Government

Department of Consumer Affairs

The 2005-06 Governor's Budget includes total expenditures of \$386.7 million for the Department of Consumer Affairs. The Governor's Budget proposes the following for 2005-06:

Bureau of Automotive Repair Consumer Assistance Programs—The Governor's Budget includes \$13.6 million and 19.9 positions for the Vehicle Retirement Program and \$4.8 million and 16.2 positions for the Repair Assistance Programs operated by the Bureau of Automotive Repair. Chapters 703 and 230, Statutes of 2004, provided increased revenue for these programs. The funding included in the Budget will allow more individuals to take advantage of these programs, resulting in cleaner air for all Californians. The Repair Assistance Program provides a repair subsidy to eligible low-income individuals and to consumers whose vehicles meet specified emissions criteria. The Vehicle Retirement Program provides a cash incentive to consumers who voluntarily scrap their vehicles after failing an emissions test.

Underground Economy Statewide Investigative Fraud Team—The Governor's Budget includes \$1 million and

10.5 positions for the Contractors State License Board to increase enforcement activities in an effort to reign in the underground economy. In coordination with departments under the Labor and Workforce Development Agency, the Board will target unlicensed contractors through sweep and sting operations and will increase the number of investigations opened as a result of consumer complaints against unlicensed contractors. This effort is part of the Administration's "Economic and Employment Enforcement Coalition" initiative focused on reigning in the underground economy.

Employment Development Department

The 2005-06 Governor's Budget includes total expenditures of \$11.6 billion for the Employment Development Department (EDD). The Governor's Budget proposes the following for 2005-06:

Benefit Audit Backlog—The Budget provides \$9.1 million and 147 positions to liquidate EDD's Benefit Audit backlog. Using a variety of methods, EDD conducts benefit audits to help recover overpayments. In recent years, EDD has had to redirect audit staff to other activities. Current audit staff is focused on the most recent inventory of claims. EDD will eliminate the backlog that has been built up in recent years by temporarily adding staff.

Underground Economy—The Budget includes \$2.5 million and 23.8 positions for EDD to participate in the Economic and Employment Enforcement ("Triple E") Coalition, a partnership of enforcement agencies that will identify the worst offenders for targeted workplace enforcement actions throughout the state. Members of the coalition will build from their individual expertise to create a team of enforcement officials with better information, access, and ability than previous efforts have produced.

Department of Industrial Relations

The 2005-06 Governor's Budget includes total expenditures of \$344.1 million for the Department of Industrial Relations. The Governor's Budget proposes the following for 2005-06:

Underground Economy Enforcement—The Budget includes \$3 million and 27.5 positions for the Department of Industrial Relations to participate in the "Triple E" Coalition, a partnership of enforcement agencies that will identify the worst offenders for targeted workplace enforcement actions throughout the state. Members of the coalition will build from their individual expertise to create a team of enforcement officials with better information, access, and ability than previous efforts have produced.

Governor's Office

Governor's Office Position and Funding Augmentation—Pursuant to Control Section 4.35, of the 2004 Budget Act, the Department of Finance has identified all positions on loan to the Governor's Office from various State departments and agencies. The Budget includes an augmentation of \$12.2 million General Fund in 2004-05 and 2005-06 for the Governor's Office to fund costs associated with the transfer of 116 loaned positions. The Budget also includes a reduction of 14 positions in 2004-05 and 2005-06, to align authorized positions with available funding.

California Gambling Control Commission

Tribal-State Gaming Compact Workload—The Budget includes a current year augmentation of more than \$2.2 million, comprised of \$2.2 million Indian Gaming Special Distribution Fund and \$54,000 Gambling Control Fund, and a 2005-06 augmentation of \$4.8 million, comprised

of \$4.7 million Indian Gaming Special Distribution Fund and \$124,000 Gambling Control Fund, to address workload resulting from new Tribal-State Gaming Compacts in 2004, including development and implementation of a state testing laboratory and field testing program, and auditing activities to ensure compliance with new and amended Compacts and gambling laws.

Department of Veterans' Affairs

The 2005-06 Governor's Budget includes total expenditures of \$ 301.5 million for the Department of Veterans Affairs. The Governor's Budget proposes the following for 2005-06:

Convert Chula Vista Residential Care Beds to Intermediate Care Beds—The Governor's Budget includes funds to convert Residential Care for the Elderly Beds to Intermediate Care Facility Beds at the Chula Vista Home. Included are an increase of \$2 million federal funds and 8.4 positions and a decrease of \$940,000 General Fund for the conversion, which will increase the federal funding share of cost.

Northern California Veterans' Cemetery—The Governor's Budget includes \$446,000 (\$327,000 General Fund and \$119,000 federal funds) and 1 position for federally required operation and maintenance of the new Northern California Veterans' Cemetery.

New Air Conditioner for Yountville Veteran's Home—The Governor's Budget includes \$832,000 (\$200,000 General Fund and \$632,000 federal funds) for new air conditioning for the Yountville Veterans Home.

Department of Food and Agriculture

The 2005-06 Governor's Budget includes total expenditures of \$302.8 million for the Department of Food and

Agriculture. The Governor's Budget proposes the following for 2005-06:

Mediterranean Fruit Fly Preventative Release

Program—The Governor's Budget continues \$8 million General Fund and 137 positions to reduce the growing threat to California from invasive pests. This funding supports the Mediterranean Fruit Fly Preventative Release Program and related public outreach activities.

Funds to Address Emerging Threats to Food

Production—The Governor's Budget includes \$2.7 million General Fund and 17 positions to address emerging threats to California's food supply through animal disease such as Avian Influenza and Mad Cow Disease as well as from the threat of bioterrorism.

Replace Veterinary Lab Equipment—The Governor's Budget includes \$1.3 million General Fund to replace old and outdated laboratory equipment in the Department's Veterinary Labs.

Milk and Dairy Food Safety Compliance— The Governor's Budget includes \$1.1 million Agriculture Fund and 5 positions to inspect dairy farms for sanitation and food safety compliance, and for training and evaluation of licensed bulk milk samplers and weighers. Funds are deposited by the dairy industry based on an assessment applied to the quantities of milk produced.

Los Angeles County Detection and Trapping—The Governor's Budget includes an augmentation of \$760,000 General Fund for full year funding for positions in Los Angeles County for the Detection and Trapping Program enacted in Chapter 631, Statutes of 2004 (AB 1896) for activities associated with containment and eradication of various fruit flies and pests.

Department of Insurance

The 2005-06 Governor's Budget includes total expenditures of \$193.8 million for the Department of Insurance. The Governor's Budget proposes the following for 2005-06:

Information Technology—The Governor's Budget includes an increase of \$6.8 million Insurance Fund and 7.1 positions to support information technology projects to assist the Department in meeting its mission by upgrading the data cabling (\$361,000), replacing older computers (\$729,000), creating an internal portal to improve the sharing of databases and other information within the Department (\$2 million and 1.9 positions), upgrading the Department's telecommunications system (\$3.5 million and 1.4 positions), and positions to address increased information technology workload (\$335,000 and 1.9 positions).

Insurance Enforcement Activities—The Governor's Budget includes \$647,000 and 3.8 Administrative Law Judge positions to address increased workload to hear cases such as those concerning workers' compensation, insurance company insolvencies, and rate increases.

Credit Card Convenience Fees—In order to encourage the public to use the Internet to conduct business with State agencies, the Governor's Budget includes \$200,000 Insurance Fund to pay credit card convenience fees for those making payments to the Department of Insurance online using credit cards.

Secretary of State

The 2005-06 Governor's Budget includes total expenditures of \$76.4 million for the Secretary of State. The Governor's Budget proposes the following for 2005-06:

Help America Vote Act Implementation—In 2003-04 the State received \$84.5 million federal funds to support

activities required by the federal Help America Vote Act (HAVA) of 2002. In the spring of 2004, \$264.4 million in additional federal HAVA funds were provided to the State. Some funds were approved for expenditure in 2004-05; however, the Legislature restricted the release of a portion of the original grant and the subsequent HAVA funding pending the receipt of a plan for the use of HAVA funds and approval by the Department of Finance and the Legislature. The plan is currently under administrative review.

Franchise Tax Board

The Franchise Tax Board (FTB) administers the personal income tax and corporation tax, as well as the Homeowners and Renters Assistance Programs, child support collections, child support automation, Department of Motor Vehicles' collections, courts collections, and Political Reform Act audits.

Abusive Tax Shelters—The Budget is proposing \$1.8 million and 17.1 positions to increase staffing for the Abusive Tax Shelter Taskforce. Abusive tax shelters are considered one of the most significant areas of tax evasion at both the State and federal levels. These tax shelters lack any economic purpose other than reducing taxes and often involve multiple layers of domestic and foreign corporations. The additional funding to combat abusive tax shelters is expected to generate \$43 million in revenue in 2005-06 and \$60 million in 2006-07.

Tax Gap Enforcement—The Budget proposes a package of five measures to reduce the tax gap at a cost of \$8.6 million annually and 99.2 positions. The tax gap is the difference between what taxpayers owe and what they voluntarily pay. It is estimated that approximately 14 percent of income taxes owed are not paid. These measures will generate an estimated \$34 million in 2005-06, increasing to nearly \$46 million in 2006-07.

Child Support Enforcement—The FTB's budget includes an augmentation of \$26.1 million General Fund, \$52.9 million reimbursements, and 15.5 positions to continue the statewide child support enforcement system development effort in 2005-06. It also includes an augmentation of \$170,000 General Fund and \$330,000 reimbursements for activities related to the State disbursement unit.

Changes in the Senior Citizens' Tax Assistance Programs—The Budget proposes to replace the current Senior Citizens' Property Tax Assistance Program with an expansion in the Senior Citizens' Property Tax Deferral Program. In addition, the benefits and eligibility for the Senior Citizen Renters' Tax Assistance are being scaled back (see the Tax Relief section for more detail). The changes in these programs will result in savings of \$575,000 and 12 positions in the Franchise Tax Board's budget for 2005-06.

Tax Relief

In line with the recommendation of the California Performance Review, the Budget proposes replacing the Senior Citizens' Property Tax Assistance Program with expansion of the Senior Citizens' Property Tax Deferral Program. Currently, the Senior Citizens' Property Tax Assistance Program allows a once-a-year payment from the State to qualified individuals based on a portion of the property taxes paid on their homes. Instead of this grant, eligible individuals will be able to defer their property tax payment under the Senior Citizens' Property Tax Deferral Program. The Budget proposes an increase in the income limit on that program, so that all individuals who were previously eligible for the grant program would now be eligible for deferral. For most taxpayers, this program will provide more financial assistance than the grant program did. Also, due to the need to bring the Budget into structural balance, the Senior Citizen Renters' Tax Assistance program benefits are proposed to be scaled back to reduce program costs.

General Government

Benefits will be returned to levels slightly above the 1998 level. In total, these changes will result in General Fund savings of \$135.9 million.

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Capital Outlay

The Governor's Budget proposes \$1.2 billion for capital outlay projects, not including funding for transportation, K-12 schools, and State conservancies. The General Fund provides \$73.7 million of the total; \$144.9 million is proposed from lease-revenue bonds; \$85.8 million is from other funds; and \$882.4 million is from higher education bonds and other general obligation (GO bonds).

The Governor's Budget proposes:

- \$829.1 million Proposition 55 funds for numerous construction projects within the University of California, the California State University, and the California Community Colleges that help meet the needs of increasing enrollment, replacement of aging facilities, and renovation of existing buildings to address critical infrastructure deficiencies, as well as seismic concerns.
- \$49.1 million lease-revenue bonds for the Department of General Services to renovate the State Library and Courts Building in Sacramento. This renovation will address significant critical infrastructure deficiencies to preserve the historic character of this state landmark built in 1928.

- \$34.6 million State Transportation Fund to continue the seismic retrofit of the Caltrans Oakland district office building.
- \$18.3 million General Fund and \$28.9 million lease-revenue bonds for the Department of Corrections to construct waste-water and potable water treatment projects to meet licensing requirements, solid cell-fronts and small management yards to address safety issues, and a heating ventilation and air conditioning project to address critical infrastructure deficiencies.
- \$16.9 million General Fund for the Department of General Services to continue the seismic retrofit for the historic Building 22 at San Quentin State Prison. This building has been rated a seismic level VI meaning it would experience extensive structural damage in an earthquake. This project will provide for the protection of lives and should enable re-occupancy within several days of an earthquake.
- \$16.6 million lease-revenue bonds for the Department of Education, State Special Schools and Services Division for career and technical education facilities to address significant critical infrastructure deficiencies at the California School for the Deaf in Riverside.
- \$8.6 million lease-revenue bonds for the Department of Justice to replace a critically deficient Santa Rosa Forensic Laboratory Facility to serve Marin, Sonoma, Napa, and Lake Counties.
- \$3.6 million General Fund for the Department of the Youth Authority to provide fire protection sprinkler systems at various institutions consistent with building code requirements, and to replace a kitchen blast chiller and its surrounding foundation which has eroded.

- \$1.5 million General Fund for the Office of Emergency Services to continue the construction of a perimeter fence at its headquarters to provide the necessary security for the facility.

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Assistance to Local Government

The Governor's Budget includes funding in various budgets that support activities by local government agencies where the local agencies have significant discretion over the use of the funds. Such programs include law enforcement, realigned health and mental health services, public health, property tax administration, Williamson Act open space preservation contracts, libraries, recreational facilities, flood control, and housing. Funding for these programs will be approximately \$5.6 billion.

With the passage of Proposition 1A, local governments can now rely on a much more stable funding relationship with state government. State government can no longer shift costs or fail to provide timely mandate reimbursements. State government cannot reallocate local revenues to benefit state priorities.

The Administration will be proposing additional fiscal reform measures for state government, which will further protect local funding by eliminating the possibility of suspending Proposition 42, from which local governments will derive significant additional funds for transportation.

Generally, the economic outlook is positive for all regions of the state, with signs of recovery—even in the hardest-

hit parts of the state, like the Bay Area. As a result, local revenues are expected to show solid growth over the next few years.

Given the State's focus on bringing order to its own fiscal affairs, in the future, local governments must look to their own resources and financial management to solve local problems and meet local priorities.

Changes in Local Government Financing

Citizen's Option for Public Safety/Juvenile Justice

Realignment—Funding for the Citizen's Option for Public Safety program, which supports front-line local law enforcement, sheriffs' departments for jail construction and operations, and district attorneys for prosecution, is maintained at \$100 million for 2005-06. The Budget also proposes that the \$100 million in funding associated with the Juvenile Justice Crime Prevention Act program be reduced by \$75 million and the remaining \$25 million be shifted to the Board of Corrections for distribution to local governments.

Small and Rural Sheriffs—Funding for this program, which provides grants of \$500,000 each to 37 sheriffs departments in the smaller counties of the state is eliminated in the 2005-06 Governor's Budget, for a savings of \$18.5 million.

Property Tax Administration Grants—Grants to counties for property tax administration are funded at \$54.3 million, which is a decline of \$5.7 million from the 2004-05 funding level.

Statewide Issues

Contributions to the Teachers' Retirement System

- This proposal would eliminate the State's annual contribution to the California State Teachers' Retirement System's (CalSTRS) Defined Benefit Program and shift the responsibility for these payments to school districts and/or the covered employees in order to ensure an effective link between future costs and benefits of the teachers' retirement system. Initially, school districts will be expected to pay an additional 2 percent of payroll, but they will be provided authority to shift this cost in whole or in part to teachers through collective bargaining agreements. Recognizing that this shift could ultimately result in less take-home pay for teachers, this proposal is coupled with a proposal to permit teachers to opt out of the recently created Defined Benefit Supplement Program. Those teachers who choose to opt out of the Defined Benefit Supplement Program will realize an immediate increase in compensation equal to a 2 percent raise. This proposal will result in General Fund savings of \$469 million.

Employee Compensation Reform

- The Governor's Budget proposes a number of employee compensation reforms that are estimated to save \$741.3 million (\$407.7 million General Fund) in 2005-06. The following proposals are intended to restructure the responsibility for future pension costs, give the Governor and the Legislature more flexibility to address budget shortfalls, provide cost containment for the rising costs of health care, and bring the State's civil service compensation more in line with other public and private entities:
- **Employees Pay One-Half of Contribution to the California Public Employees' Retirement System (CalPERS)**—Beginning in 2005-06, employees will be expected to pay one-half of the total charges approved by the CalPERS Board of Administration, including both the charges for normal costs and the charges for any unfunded liability. This proposal will initially affect those bargaining units whose memoranda of understanding will have expired by July 2005 and will reduce General Fund costs by \$205.8 million (\$374.1 million all funds). Additional bargaining units will be included as their contracts expire.
- **CalPERS Opt Out for State Employees**—This proposal would allow employees to opt out of membership in CalPERS. The State would then make no contributions to CalPERS on their behalf. For those employees who elect to opt out of CalPERS, the State will share the savings by augmenting the employees' salary with an amount equal to 50 percent of the normal retirement cost for that employee. This is estimated to reduce General Fund expenditures by \$90.2 million (\$164 million all funds).

- **Furlough All Employees in Non-Public Safety or Level-of-Care positions**—This proposal would allow the Governor to authorize a five-day furlough for all State employees not working in public safety or providing level-of-care services in a year in which a fiscal shortfall exists. This would reduce General Fund expenditures by \$60 million (\$109 million all funds).
- **Eliminate Leave From the Calculation of Overtime**—Under this proposal, time when an employee is excused from work because of holidays, sick leave, vacation, annual leave, compensating time off, or any other paid leave time shall not be considered as “time worked” for purposes of determining premium overtime compensation. This is expected to reduce General Fund expenditures by \$20 million (\$36.4 million all funds).
- **Health Benefit Reforms**—The State proposes to eliminate the percentage formulas for health care contributions and contribute a fixed dollar amount to each employee based on the number of people covered in the family unit. The State is also proposing to eliminate funding for health care for new employees until they have passed their probationary period. These changes are expected to reduce General Fund expenditures by \$30 million (\$55.3 million all funds).
- **Eliminate Two Holidays**—The State proposes to eliminate two paid holidays that are provided to each employee to bring paid leave more in line with the average number of holidays provided by other public agencies. This is expected to reduce General Fund expenditures by \$1.7 million (\$3.1 million all funds).
- **Limit Leave Accrual to a Total of 640 Hours**—This proposal will save the State from future liabilities because employees will be unable to accrue more than 640 hours, which can be cashed out when an employee retires. The fiscal impact of this proposal cannot be

determined, so no savings are reflected in current budget projections.

Health and Dental Benefits for Annuitants

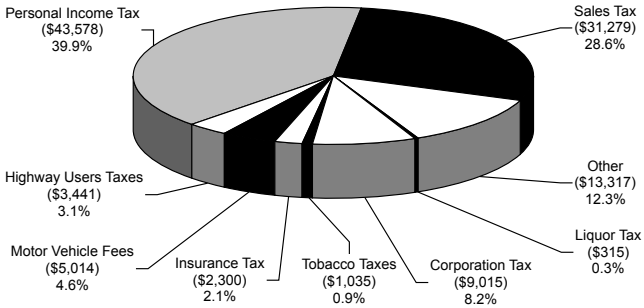
- The Budget proposes an increase of \$65 million in 2005-06 based on both premium and enrollment growth. This increase includes an offsetting savings of \$35 million due to the federal Medicare Reform Act, to be implemented January 1, 2006, which will provide employers with significant savings in drug costs for retirees.

\$150 Million General Fund Reductions to State Operations

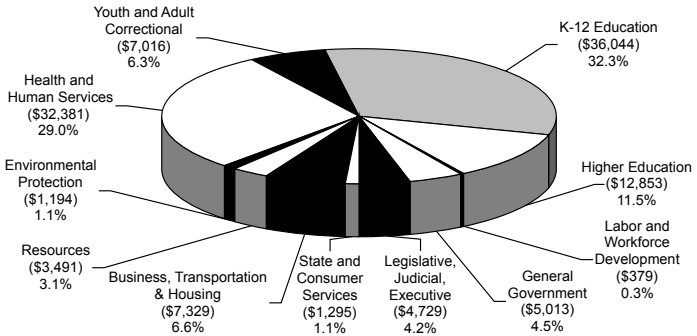
- In addition to specific reductions in major program areas, state operations budgets for departments within the Administration are proposed to be reduced by a total of \$150 million General Fund. The departments have the flexibility to use lay-offs, hiring freezes, procurement reductions, or other administrative means to achieve these reductions, at the departments' discretion.
- These reductions do not apply to entities outside of the Administration. However, in light of the existing State fiscal situation, the Administration invites Constitutional Officers and the other co-equal branches of state government to participate in the endeavor to reduce their General Fund budgets.

Summary Charts

**2005-06
Total Revenues and Transfers**
(Dollars in Millions)



**2005-06
Total Expenditures
(Including Selected Bond Funds)**
(Dollars in Millions)



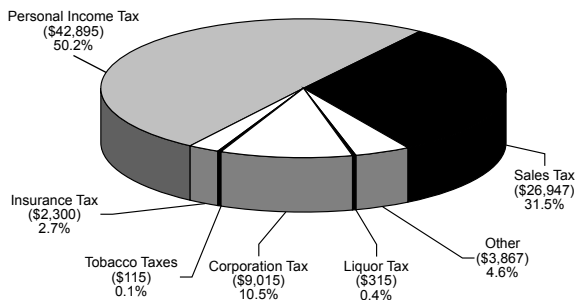
Summary Charts

2005-06 Governor's Budget General Fund Budget Summary (Dollars in Millions)

	2004-05	2005-06
Prior Year Balance	\$3,489	\$1,425
Revenues	\$77,904	\$83,227
Transfers	\$315	\$544
Economic Recovery Bonds	<u>\$2,012 ^{1/}</u>	<u>\$1,683</u>
Total Resources Available	\$83,720	\$86,879
Non-Proposition 98 Expenditures	\$48,171	\$49,206
Proposition 98 Expenditures	<u>\$34,124</u>	<u>\$36,532</u>
Total Expenditures	\$82,295	\$85,738
Fund Balance	\$1,425	\$1,141
Budget Reserves:		
Reserve for Liquidation of Encumbrances	\$641	\$641
Special Fund for Economic Uncertainties	\$784	\$500

^{1/} For the purposes of this chart, this amount is included in General Fund resources to provide better comparability. It was budgeted as a reduction in expenditures in the 2004 Budget Act.

2005-06
General Fund Revenues and Transfers
(Dollars in Millions)

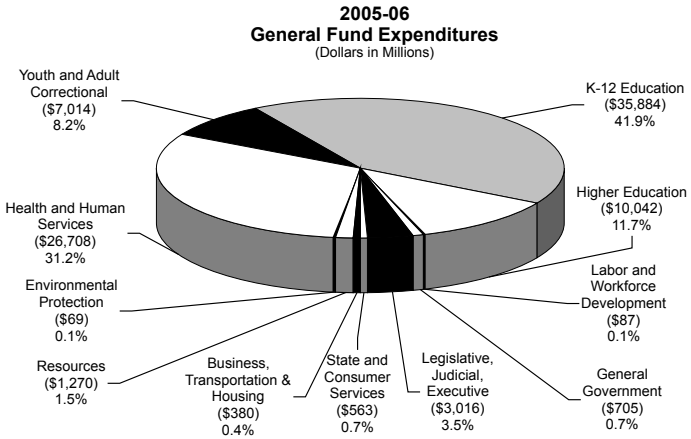


2005-06 Revenue Sources
(Dollars in Millions)

	General Fund	Special Funds	Total	Change From 2004-05
Personal Income Tax	\$42,895	\$683	\$43,578	\$3,797
Sales Tax	26,947	4,332	31,279	2,013
Corporation Tax	9,015	-	9,015	337
Highway Users Taxes	-	3,441	3,441	85
Motor Vehicle Fees	21	4,993	5,014	176
Insurance Tax	2,300	-	2,300	70
Liquor Tax	315	-	315	3
Tobacco Taxes	115	920	1,035	-30
Other	3,846	9,470	13,316	2,592
Total	\$85,454	\$23,839	\$109,293	\$9,043

Note: Numbers may not add due to rounding.

Summary Charts



General Fund Expenditures by Agency (Dollars in Millions)

	2004-05	2005-06	Change	%
Legislative, Judicial, Executive	\$2,873	\$3,016	\$143	5.0%
State and Consumer Services	535	563	28	5.2%
Business, Transportation & Housing	377	380	3	0.8%
Resources	1,067	1,270	203	19.0%
Environmental Protection	74	69	-5	-6.8%
Health and Human Services	25,543	26,708	1,165	4.6%
Youth and Adult Correctional	6,933	7,014	81	1.2%
K-12 Education	34,435	35,884	1,449	4.2%
Higher Education	9,363	10,042	679	7.3%
Labor and Workforce Development	87	87	-	0.0%
General Government	1,008	705	-303	-30.1%
Total	\$82,295 ^{1/}	\$85,738	\$3,443	4.2%

^{1/} For purposes of this chart, the use of Economic Recovery Bonds (\$2.012 billion) is included in resources to provide better comparability. It was budgeted as a reduction in expenditures in the 2004 Budget Act.

Note: Numbers may not add due to rounding.

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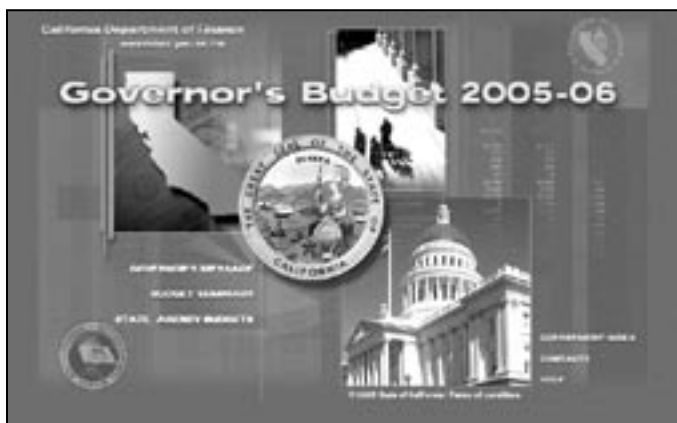
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Introducing the Governor's Budget Website



The 2005-06 Governor's Budget and Budget Summary are available on the Internet at: govbud.dof.ca.gov.

This website provides access to all 2005-06 Governor's Budget and Budget Summary data, as well as additional Budget reference information, through an easy-to-use point-and-click interface. The following two pages provide a brief overview of the website's features and navigation.

From the website's Home Page, you can directly access the following:

Governor's Message

Presents the Governor's Message to the members of California's Legislature in accordance with Article IV, Section 12 of the State Constitution.

Budget Summary

Presents the Governor's goals and objectives for the forthcoming year, policy perspectives, and highlights of the changes. It also provides an overview of the proposed budget and highlights major changes for each program area included in the Budget.

State Agency Budgets

Provides detailed budget information for State agencies and departments. By selecting an agency, you will be able to view summary information for the agency and detailed budget information (including detailed financial statements and charts) for each department included in the agency.

Department Index

Provides an alphabetical index of all departments included in the Budget. This index can be used to quickly access information for a specific department.

Contacts

Provides a listing of budget contacts in the California Department of Finance.

Help

Provides useful information regarding features of this website including navigating the website, printing, and technical requirements.

Quick On-Line Access to Data

Once within the website, a variety of links provide quick access to data.

Left-Side Menu Items

The Left-Side Menu provides direct access to the major chapters of the Budget Summary and each State agency in the Governor's Budget. In addition, access is provided to Budget References. The Budget References web page provides access to the most requested budget-related reference items related to the Budget and budget process.

Top Menu Items

The Top Menu provides quick access to select external websites and useful website information. Through the Top Menu, direct access is provided to the State of California website, California Department of Finance website, Governor's website, Department Index, Web Site Map (which provides descriptions and quick links to web pages), and Help.

Right-Side Menu Items

The Right-Side Menu is dynamic. Menu options will change based on the web page displayed. You will see a Right-Side Menu only if there is additional information available related to the Agency, Department, or Budget Summary section you are viewing. (Note: The Right-Side Menu options are not available on all web pages.)

Printing

Each Agency Budget Chapter, Department Budget Chapter, and Budget Summary Chapter is available as a .pdf file and can be printed using Adobe Acrobat software. The chapter's .pdf file is available under Additional Information on the respective web page.